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DOD'S INADEQUATE USE OF OFF-THE-SHELF ITEMS

REPORT

PREPARED BY THE

SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

OCTOBER 30, 1989

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LETTER OF TRANSMITTAL

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC, October 27, 1989.

Hon. JOHN GLENN,
Chairman, Committee on Governmental Affairs,
Washington, DC.

DEAR MR. CHAIRMAN: The Subcommittee on Oversight of Government Management transmits the following report on its examination of the acquisition of commercial and off-the-shelf products—known as "non-developmental items" or "NDI's" by the Department of Defense.

The Subcommittee held two hearings on NDI's on May 16, 1989, and June 1, 1989, pursuant to the Committee's jurisdiction over government-wide procurement issues. In the course of these hearings, the Subcommittee learned that there are substantial impediments to the acquisition of NDI's by the Department of Defense and that DOD has done little to implement a 1986 provision requiring the removal of such impediments.

In one case examined by the Subcommittee, the Navy has been unable to obtain the most advanced radar equipment available for its new antisubmarine aircraft, because the commercial manufacturer of the equipment determined that contract terms required by DOD were inconsistent with its commercial accounting systems. In a second case, the Subcommittee learned that the Air Force is currently unable to purchase routine spare parts needed for the Airborne Warning and Control System (AWACS), because the prime contractor cannot make the sales without re-opening hundreds of subcontracts to impose DOD-required contract terms.

Based on our analysis of these problems, the Subcommittee has made 16 recommendations for removing impediments to the acquisition of NDI's. Implementation of these recommendations would, we believe, go a long way to streamline the federal procurement system and save taxpayer dollars.

Sincerely,

CARL LEVIN,
Chairman, Subcommittee on Oversight
of Government Management.

Enclosure.

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I. INTRODUCTION

The Department of Defense purchases many items that are commercially available or have already been developed for other government agencies, including products ranging from clothing and food to sophisticated computer and electronics equipment. These products that are already in use or could be available to meet government needs with only minor modification are called "non-developmental items", or "NDI's".

Section 907 of the National Defense Authorization Act For Fiscal Year 1987 established a preference for the acquisition of NDI's by the Department of Defense. The implementation of that provision and the need for increased attention to NDI acquisition is the focus of this Report.

A. The Benefits of Nondevelopmental Items Acquisition

The Department of Defense buys many products—such as missiles, submarines, and aircraft carriers—that are built solely for the use of the military. Because these products are built to meet unique military needs and are not purchased by anybody else, DOD must establish its own specifications and testing requirements to make sure that the products it buys will meet its needs.

Moreover, because there is generally no commercial market to test the price and quality of these products, the DOD has developed its own regulatory requirements and monitoring systems to test contractor price and quality. DOD audits contractors' accounting and cost estimating systems to determine price reasonableness; it inspects contractors' processes and products to ensure quality.

The process of designing a unique product from scratch can be extremely expensive, particularly where the product is purchased in limited quantities. Moreover, DOD's requirements and systems for testing price and quality are considered by many in industry and government to be far more extensive than the market-testing generally applied in commercial sales.

In short, DOD requires special monitoring, auditing, and testing for military-unique systems. These procedures are clearly necessary when we purchase systems that have not been tested with commercial sales. However, many such procedures are unnecessary or inapplicable to products that have already been successfully developed and produced.

These special requirements cost a contractor time and money and, therefore, cost DOD and the taxpayer time and money. The cost impact of developing a unique product and applying DOD monitoring requirements and systems can be seen when DOD purchases items that are in common use in the commercial world. As a result, there are numerous examples of extraordinary prices

charged to the government for ordinary products—from the $640 toilet seat to the $7,622 coffee maker.

The acquisition of NDI's can lower initial purchase costs by reducing or eliminating the need for research and development. Acquisition leadtime can be reduced since NDI's are readily available and can be produced on existing production lines. Because the product is already developed and has been shown to work, the need for detailed design specifications and extensive testing is also reduced.

Moreover, in the case of a commercial product, the competitive marketplace also provides assurance that the price is reasonable, substantially reducing the need for costly examination of the contractor's books and records. Overall product costs can be further reduced through the use of existing product support systems maintained by the commercial vendor. Use of these systems can reduce the need for DOD to manage inventories and distribute spare and replacement parts where they are needed as well as rely on its own personnel to maintain and repair equipment. Additionally, many commercial manufacturers provide product warranties which, if utilized, can reduce maintenance and repair costs to the government.

The acquisition of NDI's can also enhance competition and strengthen the defense industrial base. When the Department of Defense develops a product from scratch, competition is limited to those contractors who are willing to design and build a product for DOD alone. By purchasing existing products, the DOD can open competition to thousands of other manufacturers who sell similar products to other purchasers. By developing such new sources of supply, DOD also reduces its reliance on the narrow segment of domestic industry which is devoted solely to defense production.

In some cases, the acquisition of NDI's can also enable DOD to acquire advanced technology in a more timely manner. Technological growth occurs naturally in the competitive commercial marketplace. Reducing acquisition leadtime and eliminating the need for designing its own products allows DOD to use the newest technological advances as quickly as the most competitive commercial businesses.

In short, the increased acquisition of NDI's can reduce research and development costs, trim acquisition lead-times, streamline audit and testing requirements, reduce inspection and maintenance costs, increase competition, strengthen the defense industrial base, and even speed the acquisition of advanced technology by the Department of Defense.

B. Historical Background

The idea that DOD should buy non-developmental items when such products will meet its needs is certainly not a new one. For almost twenty years, study after study has endorsed the use of commercial products and NDI's and urged DOD to increase its use of such products. Despite these studies and their recommendations, however, progress toward increased use of NDI's has been frustratingly slow.

The Commission on Government Procurement initiated the push for commercial products acquisition in its 1972 Report, which concluded that there is a "need for a shift in fundamental philosophy relative to commercial product procurement and for the establishment of a continuous oversight function to review agency policies and procedures."

Four years later, a Defense Science Board Task Force on Electronic Test Equipment reviewed the problems faced by a specific industrial sector, and reached a similar conclusion. One of the task force's key recommendations was that off-the-shelf electronic test equipment should be considered more completely during the early stages of weapon system development and during formulation of other needs for electronic test equipment. The Task Force estimated that its recommendations, if adopted, would result in annual savings of $80 million in purchases of electronic test equipment alone.

In 1977, a second Task Force of the Defense Science Board reported on Specifications and Standards. This Task Force started the push toward functional and performance specifications that could be met by NDI's by recommending a program "to improve the body of specifications and standards by emphasizing increased flexibility and reduced cost of application in revisions and consolidation."

In 1976, the push for NDI acquisition picked up steam when the Office of Federal Procurement Policy (OFPP) issued a policy memorandum requiring the purchase of commercial and off-the-shelf products whenever possible. The OFPP memorandum, dated May 24, 1976, stated that:

> The Government will purchase commercial, off-the-shelf products when such products will adequately serve the Government's requirements, provided such products have an established commercial market acceptability. The Government will utilize commercial distribution channels in supplying commercial products to its users.

Even before the issuance of the OFPP memorandum, the Department of Defense had announced the establishment of the "Commercial Commodity Program" in a memorandum to the military services dated December 30, 1975. The objective of the program was "to ensure that due consideration is given to the procurement and utilization of commercial commodities in those instances where these commodities will meet the requirements profile stipulated for intended application." The memorandum anticipated payoffs in the areas of—

> Lower life cycle cost, increased reliability as a result of not consistently pushing the state of the art, achievement of a relatively high degree of standardization while avoiding built-in obsolescence, reductions in manpower and facility support requirements, improvement in the industrial base, and improved competition allowing us to avoid the "sole-source box" into which we so often maneuver ourselves.

A DOD pilot program was initiated in January 1977 and ended in 1979. Based on program experience, a DOD concluded that purchasing commercial products increased competition, generally provided more favorable prices, generally provided equal or better quality products, generally reduced delivery times, and did not adversely affect small businesses.

In 1978, DOD recognized the success of the pilot program and issued Directive 5000.37 on the Acquisition and Distribution of Commercial Products (1978). This directive established the policy that DOD components were to—

> Purchase commercial, off-the-shelf, products when such products will adequately serve the Government's requirement, provided such products have an established commercial market acceptability, and
>
> Use commercial distribution channels in supplying commercial products to users when it is economically advantageous to do so and the impact on military readiness is acceptable.

Despite these programs, DOD's efforts to purchase non-developmental items were widely recognized as falling short of their potential. Between 1977 and 1980, the General Accounting Office issued three separate reports criticizing the inadequate efforts of DOD and other agencies to utilize NDI's.

In a November 1977 report entitled "Government Specifications for Commercial Products—Necessary or a Wasted Effort?," the GAO concluded that "[m]any Government specifications were outdated, too complex, and too costly to develop and maintain, and these deficiencies eliminated to a large extent the primary advantages attributable to specifications—standardization and competitive procurement."

In an April 1979 report entitled "Opportunities and Problems in Meeting the Military's Clothing and Textile Needs with Commercially Available Items," the GAO found that the Defense Logistics Agency had failed to implement the OFPP policy on purchasing commercial, off-the-shelf products with regard to clothing and textile items, approving the purchase of only 19 off-the-shelf items out of a total of 4,500 items managed over the three-year life of the program.

In a January 1980 report entitled "Implementation of Federal Policy on Acquiring and Distributing Commercial Products is Faltering Badly," the GAO concluded that "[t]he Defense Department's implementation [of the OFPP policy on commercial, off-the-shelf products] is fragmented, and the Department's Defense Logistics Agency continues to purchase, stock, and distribute low-demand value products; and its policies, procedure, practices, and methods are biased against the commercial products policy."

Similarly, in May 1980, the Defense Audit Service issued a highly critical report on its review of DOD's Acquisition and Distribution of Commercial Products Program (the ADCOP Program). This report concluded that "little progress has been made to increase the procurement of commercial products under the ADCOP program initiative."

In 1982, President Reagan renewed the push for increased acquisition of commercial products in Executive Order 12352 on Federal Procurement Reforms. Executive Order 12352 directed executive agencies to:

> Establish criteria for enhancing effective competition and limiting noncompetitive actions. These criteria shall seek to improve competition by such actions as eliminating unnecessary Government specifications and simplifying those that must be retained, expanding the purchase of available commercial goods and services, and,

where practicable, using functionally-oriented specifications or otherwise describing Government needs so as to permit greater latitude for private sector response.[1]

A year later, the Department of Defense issued a proposal to revise and streamline regulations and contract clauses to be used in commercial contracts. The proposed revisions to the Defense Acquisition Regulations (DAR)—which would have made it substantially easier for DOD to purchase commercial products by simplifying commercial contracts—appeared in the *Federal Contracts Report,* but were never issued.

In 1984, the President's Private Sector Survey on Cost Control again focused on increased use of commercial products and simplified specifications as a means of cutting procurement costs. The report concluded that while the government's commercial products program "had a successful start[,] it does not appear to have continued at the pace of 1980–1981."

In January 1986, a report issued by the Georgetown Center for Strategic and International Studies, January 1986 reiterated the need for simplified specifications, concluding that "products acquired by * * * specifications have been found to cost more and to be of poorer quality than comparable items readily available in the commercial marketplace." The study recommended—

A crash program of one year's duration that has two points of focus: First, the evaluation of vast numbers of existing specifications and their conversion to product descriptions appropriate for commercial buying; secondly, a training program to prepare DOD purchasing officers for commercial buying.

Finally, in February 1986, the President's Blue Ribbon Commission on Defense Management (The Packard Commission), issued its report. The Packard Commission concluded that—

Rather that relying on excessively rigid military specifications, DOD should make greater use of components, systems, and services available "off-the-shelf." It should develop new or custom-made items only when it has been established that those readily available are clearly inadequate to meet military requirements.

The Commission recommended that the following actions be taken within DOD:

The Defense Acquisition Executive take steps to assure a major increase in the use of commercial products, as opposed to those made to military specifications. He should direct that program managers get a waiver before using a product made to military specifications, if there is an available commercial counterpart. When a make-or-buy decision must be made, the presumption should be to buy. This would invert present procedures, biasing the system in favor of commercial products and services, but permitting the use of items made to military specification whenever a program manager believes it necessary to do so.

In addition, we recommend that the DOD Supplement to the Federal Acquisition Regulation be changed to encourage streamlining military specifications themselves.

Thus, in 1986, fourteen years after the push for increased use of commercial products and simplified specifications began with the report of the Commission on Government Procurement little progress appeared to have been made.

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[1] At about the same time, the National Security Industrial Association concluded a study on Use of Commercial Equipment in Command, Control, Communications, and Intelligence (C-3-I) Systems. This study concluded that "The use of commercial equipment in selected C-3-I systems offers significant practical advantages both in cost and schedule and ensuring latest technology available of military applications." The study strongly recommended increased use of commercial equipment and NDI's in C-3-I systems.

C. The NDI Provision

In October 1986, Congress created a formal preference for the acquisition of nondevelopmental items. Section 907 of the National Defense Authorization Act For Fiscal Year 1987 requires the Department of Defense to ensure that, to the maximum extent possible—

(1) product requirements are stated in terms of functions to be performed, performance required, or essential physical characteristics;

(2) such requirements are defined so that they can be fulfilled by NDI's; and

(3) such requirements are in fact fulfilled by the purchase of NDI's.

In addition, Section 907 requires the Department of Defense to identify and remove regulatory impediments to the acquisition of NDI's, and notify the Congress of any statutory impediments to the acquisition of NDI's. Within one year after enactment of the legislation, the Secretary of Defense was required to submit a report to Congress:

(1) identifying actions taken to implement the legislation;

(2) identifying all statutes and regulations that impede the acquisition of NDI's; and

(3) recommending legislation deemed necessary to promote maximum procurement of NDI's.

NDI's were defined in Section 907 to include previously developed items in supply in use by any federal, state, or local government department or agency, as well as items available in the commercial marketplace. In addition, previously developed items that require only minor modification to meet DOD needs are defined as NDI's.

Through this legislative action, Congress established a formal preference for the acquisition of nondevelopmental items and mandated their acquisition when such products meet the requirements of DOD. The balance of this report addresses the actions taken by DOD to implement the legislation, the impediments to the acquisition of NDI's that still exist, and recommendations for future action.

D. The Subcommittee Hearings

In January 1989, Senator Levin directed the Subcommittee staff to investigate DOD's progress in implementing Section 907. Over the next several months, the Subcommittee staff interviewed numerous contractor representatives, who stated that little progress had been made to remove impediments to the purchase of NDI's by the Department of Defense. Many of these contractors raised specific examples of specifications, regulations, and contract clauses which made it difficult for them to do business with the government.

On March 23, 1989, the Subcommittee sent a letter to the Under Secretary of Defense for Acquisition, Robert Costello, requesting an update on the status of DOD's efforts to implement Section 907. On April 21, Dr. Costello responded to the Subcommittee's letter with a report entitled "Status of Current Efforts to Implement Section

907 of the Defense Authorization Act for 1987—Preference for Non-developmental Items."

On May 16 and June 1, 1989, the Subcommittee held oversight hearings on DOD's efforts to purchase NDI's.

At the May 16 hearing, the Subcommittee heard from representatives of contractors who had undertaken the frustrating process of trying to sell commercial products to the government. The witnesses at this hearing were: Robert Rossow of Midland Brake, Inc.; Naomi Williamson of Honeywell, Inc.; Dan Pinick of the Boeing Company; John Fluke, Jr. of John Fluke Manufacturing Company; John McGowan of Hewlett Packard Co.; and Al Herman of Tektronix, Inc.

At the June 1 hearing, the Subcommittee heard testimony from DOD witnesses regarding the Department's efforts to implement Section 907. The witnesses at the second hearing were: Deputy Secretary of Defense Donald J. Atwood; Deputy Assistant Secretary of Defense for Procurement Eleanor R. Spector; and Assistant for Commercial Acquisition Gregory Saunders. Subsequent to the second hearing, the Department of Defense provided the Subcommittee with a 31 point plan for removing impediments to the purchase of NDI's.

E. Summary of Findings

1. The Department of Defense practice of overst[illegible]g requirements precludes the Department from benefitting [illegible]n the purchase of existing systems and results in unnecessary expenditures of both time and money in developing new systems.

2. The Department of Defense has made inadequate progress in stating its needs in terms of (i) functions to be performed, (ii) performance required, or (iii) essential physical characteristics. The Department's practice of stating requirements in extreme detail discourages many contractors from even bidding on defense contracts.

3. The Department of Defense unnecessarily abandoned its effort to replace military specifications with simplified commercial item descriptions.

4. The Department of Defense continues to impose inappropriate and burdensome contract requirements in contracts for commercial products. This practice discourages many commercial manufacturers from bidding on DOD contracts.

5. Different components of the Department of Defense use different and inconsistent contract clauses for the purchase of commercial products. This practice causes confusion and uncertainty and discourages commercial manufacturers from doing business with the government.

6. The Department of Defense requires that burdensome contract clauses be flowed down to subcontractors in commercial contracts. In some cases, this requires commercial manufacturers to re-open existing contractual relationships with subcontractors, which some refuse to do. This problem is currently making it difficult for DOD to obtain needed spare parts for some systems.

7. The Department of Defense has implemented the Defense Production Act of 1950 in an overly burdensome and excessive

manner, requiring commercial contractors and subcontractors to give all DOD orders in excess of $500 or more priority over all other production.

8. The Department of Defense regulations implementing the Truth in Negotiations Act require contractors to submit certified cost or pricing data in cases where the government's interest is adequately protected by prices that have been tested in the marketplace. Problems include: (a) the failure of some contracting officers to grant exemptions in competitive procurements; (b) rigid percentage requirements for determining whether a product qualifies for the commerciality exemption; (c) the application of this exemption to new products, outdated products, and modified products; and (d) the application of the competitive and commercial exemptions to spare parts and contract modifications.

9. Existing inspection procedures of the Department of Defense can result in unnecessary burdens on commercial producers with proven records of quality production. The Department of Defense does not make adequate use of alternative means of ensuring quality, such as warranties, that have proven effective in the commercial marketplace.

10. The resources dedicated to the NDI initiative within the Office of the Secretary of Defense (OSD) and contracting activities have been inadequate to implement the NDI legislation fully throughout the Department.

11. The Department of Defense has failed to establish a training program adequate to train the acquisition community—including both requirements and contracting personnel—in the policies and procedures for acquisition of NDI's.

12. The Department of Defense has failed to establish an information system to gather and maintain data on the use of commercial products, as directed by the Office of Management and Budget in April 1988.

13. The Department of Defense does not have a formal, published set of policies and procedures at the departmental level for the acquisition of NDI's. Despite commitments made by the Department, DOD Directive 5000.37 (Acquisition and Distribution of Nondevelopmental Items) and the DOD manual on acquisition of NDI's have not been published.

14. The requirement in Part 10 of the Federal Acquisition Regulations that creates a preference for federal specifications over functional product descriptions is inconsistent with Section 907's preference for functional and performance specifications. The Department's supplement to the Federal Acquisition Regulations does not correct this problem.

15. The Department of Defense's Report to Congress on its implementation of Section 907 failed to address thirteen impediments to the acquisition of NDI's that were identified in a draft of the same report.

16. The Department of Defense has failed adequately to comply with Section 907's requirement to identify all statutes and regulations that impede the acquisition of nondevelopmental items.

F. Summary of Recommendations

1. The Department of Defense should ensure that its agencies procure NDI's when such products will fulfill agency needs. Prior to entering into a developmental contract for a product which has an NDI counterpart, an agency should conduct and document a thorough analysis of the impact of developing a new product on the cost, schedule and performance of the contract. The developmental item should be procured only if it is clearly shown that the NDI is inadequate to fulfill the minimum needs of the agency.

2. The Department of Defense should intensify its efforts to review existing specifications, replace design specifications with performance specifications, and adopt nongovernmental standards and specifications whenever possible.

3. The Department of Defense should revitalize the commercial item description (CID) program.

4. The Department of Defense should revise regulations that require the use of unnecessary and burdensome contract clauses in contracts for the purchase of commercial products.

5. The Department of Defense should ensure consistent and predictable requirements in contracts for commercial products by establishing a list of only those contract clauses that are required for inclusion in such contracts and permitting the use of other clauses only upon a determination by the contracting officer that a clause is essential for the protection of the government's interest in the procurement.

6. The Department of Defense should not require the flow-down of contract clauses to subcontractors in commercial contracts unless inclusion of a clause in such subcontracts is essential for the protection of the government.

7. The Department of Defense should require priority production of DOD orders only when such priority production is necessary to promote the national defense.

8. The Department of Defense should revise regulations implementing the Truth in Negotiations Act to ensure that contractors are required to submit cost or pricing data in competitive and commercial procurements only when it is necessary to determine whether the contract price is reasonable. In particular, the Department should review the percentage tests established in existing regulations, as well as the applicability of these regulations to new commercial products, outdated commercial products, modified commercial products, and spare parts for commercial products.

9. The Department of Defense should take advantage of alternative approaches to quality assurance, such as placing greater reliance on commercial warranties and rewarding contractors with a proven record of quality performance. The Department should develop an inspection clause for inclusion in contracts with commercial suppliers that have a proven record of quality production and offer appropriate warranties.

10. The Department of Defense should establish adequate staffing at the OSD level to formulate the Department's policy on the acquisition of NDI's and to monitor its implementation. In addition, the Department should establish a responsible individual in each contracting activity to ensure that the policy on NDI's is im-

plemented by local commands. These individuals should play an active role in encouraging the use of NDI's, ensuring that command personnel are properly trained in the use of functional and performance specifications, and challenging barriers to the use of NDI's.

11. The Department of Defense should establish a formal training program to provide for the initial training and periodic refresher training of the acquisition community in the identification, procurement, and logistical support of NDI's. This training program should cover the purchase of NDI's both as end items and as components of military-unique systems.

12. The Department of Defense should establish a system to gather and maintain data on the use of commercial products and other NDI's.

13. The Department of Defense should ensure that DOD Directive 5000.37 and the manual on acquisition of NDI's are completed and published on an expedited basis.

14. The Department of Defense should initiate a change to either Part 10 of the Federal Acquisition Regulations or the Department's supplemental instructions requiring that the Department state its needs in a manner consistent with the Section 907. The regulation should require that the Department's needs be stated, to the maximum extent practical, in terms of (i) functions to be performed, (ii) performance required, or (iii) essential physical characteristics.

15. The Department of Defense should review and determine the validity of the impediments identified in its draft report to Congress and, where appropriate, initiate action to remove such impediments.

16. The Department of Defense should undertake a systematic review of statutes and regulations that may impede the acquisition of nondevelopmental items and take necessary actions to remove such impediments.

II. DISCUSSION

A. Impediments to the Acquisition of NDI's

The witnesses at the Subcommittee's May 16, 1989 hearings identified four significant impediments to the acquisition of NDI's. These four impediments were: (i) inappropriate product descriptions and specifications; (ii) unnecessary and burdensome contract terms and conditions; (iii) inappropriate requests for certified cost or pricing data; and (iv) unnecessarily burdensome quality assurance requirements. A discussion of each follows.

1. PRODUCT DESCRIPTIONS AND SPECIFICATIONS

Product descriptions and specifications are documents used by DOD to define its requirements, i.e., to decide what it needs and then describe this need to potential suppliers.

When DOD purchases an item that is built solely for the use of the military—such as a missile, submarine, or aircraft carriers—it must establish its own specifications and testing requirements to make sure that the products it buys will meet its needs.

Even when DOD is purchasing a product similar to a common commercial item, it may have unique needs, such as storage or container requirements, or added ruggedness and longevity for use in the field. In some cases, these unique needs may require the development of a unique military product, but in other cases, they may be possible to meet with modified version of the existing commercial product (an NDI).

DOD has developed its own detailed specifications, however, for virtually everything it uses: weapons, equipment, vehicles, food, clothing, medical supplies, etc. Even common base supply items, such as residential heat pumps, are covered by specifications.[1]

When detailed specifications are used for common items, they can be a significant impediment to the acquisition of NDI's, because they frequently overstate DOD's actual needs or state these needs in excessive detail. By "overspecifying" in these manners, DOD requires contractors to perform unnecessary work, since offerors are required to fabricate products that conform exactly to the specification in order to be considered responsive.

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[1] The following is a breakdown of current specifications:

Type of Specification	*Quantity on hand*
Military specification	27,762
Federal specifications	3,730
Commercial item description	3,491
Non-government standards	4,632
Total	39,615

In addition to the above mentioned specifications, there are military and federal standards, qualified products lists, federal information processing standards, international standards, military handbooks, Army/Navy aeronautical specifications, and Air Force/Navy Aerobulletins.

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a. The problem of overspecification

There are two basic types of specifications. Design specifications, which describe the physical characteristics of a product, such as materials to be used, method of fabrication, and exact dimensions of all parts, usually make reference to engineering drawings. Performance specifications describe the standards of performance of the product, including its functions or capability, operating limits, and its reliability.

Historically, DOD has generally opted to use design specifications instead of performance specifications. This means that suppliers are told not only what to build, but also how to build it. Frequently, these specifications not only give precise dimensions for minor parts, but detail the precise manner in which these parts are to be fabricated.

For example, a military specification for chocolate chip cookies spells out precise details for making and testing the cookies. A typical paragraph, read by Senator Cohen at the Subcommittee's June 1 hearing, states—

> The cookie shall be well-baked. They shall be browned on the bottom surface and outer edges, but not appreciably browned on the top surface. They shall be wholly intact; free of checks or cracks. The weight of each cookie shall not be less than 13.7 grams. The diameter of each cookie, at its greatest dimension, shall be such as to enable easy placement of the cookie in the required lined can. However, the diameter, at its greatest dimension, shall not be less than 2 5/16 of 1 inch. The cookie shall be tender and crisp with an appetizing flavor, free of burnt or scorched flavor. Moisture content shall not be greater than 5 percent.[2]

Such overspecification results in part from the prevailing attitude of the requirements community (primarily, DOD engineers and program managers)—that DOD must design its own products to meet its own special needs. Commercial products available in the public sector are thought to be unsuitable for the extreme conditions (e.g., combat and combat training missions, prolonged time at sea, rough handling during transportation, long periods of storage) under which DOD operates. So the determination of what to acquire is usually made by designing products from scratch.

Recognizing this problem, the Council of Defense and Space Industry Associations made the following statement in a letter to DOD dated September 30, 1987:[3]

> Military standards and specifications define extreme conditions and requirements to provide for the worse case and have been developed as a "guide" to the development and production of military equipment. The U.S. Government often levies these requirements on all products, regardless of their intended use or the environment in which they must operate. In numerous cases the government may have denied itself truly current technology and suffered a cost penalty as a result of its requirements to "militarize" commercial products before their use in government procurements.

DOD's natural inclination to design products from scratch has apparently been reinforced by the need to ensure against defective products. DOD officials have told the Subcommittee that some DOD contractors have employed cost cutting measures that actually reduce the quality of the product (for example, substituting

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[2] MIL-C-1029E, Cookies, Oatmeal with Chocolate Chip and Sandwich: Canned, consisting of 15 pages. (September 28, 1973)

[3] Letter from the Council of Defense and Space Industry Associations to Mr. Greg Saunders, Assistant for Commercial Acquisition, OASD (P&L) PS/SDL, dated September 30, 1987.

poorer quality material than normally used in a particular product). As Greg Saunders explained at the Subcommittee's June 1, 1989, hearing, the resulting product deficiencies that were subsequently encountered were normally addressed by increasing the level of detail in the specification (i.e., plugging the loopholes).

When DOD states its requirements in detailed design specifications, contractors must choose among three possible alternatives: (i) build a product exactly to the specification, (ii) attempt to negotiate a waiver of parts of the specification where exact compliance is not practicable, or (iii) not bid on the contract.

Frequently, contractors choose not to bid, because building exactly to the specification would require retooling the production line, or the redesign of a product that has proven to be reliable and cost effective in the commercial market. Either case would involve disruption of normal operations and additional cost, without any actual value being added to the product. Similarly, negotiating waivers to specifications is a high-risk endeavor. Sometimes waivers are granted and sometimes they are not; in fact sometimes they are granted on one contract and then denied on a succeeding contract for an identical product. Some companies are unwilling to run the risk of successfully obtaining the required waivers so that their off-the-shelf products will be acceptable to the government buyer.

As Mr. Saunders explained in response to a question from Senator Cohen:

> Senator COHEN. I gather what you are saying is that . . . we have manufacturers who might have no credibility as such, or acceptability in the marketplace—maybe even fly-by-nighters who want to buy into DOD contracts—and therefore, in order for you to prevent the fly-by-nighter or unreliable contractor to become part of the bidding process, you have to write the restrictions into the bidding process that become more restrictive or more onerous; so that has the effect of keeping out the qualified bidders—is that what you are telling me?
>
> Mr. SAUNDERS. Unfortunately, in a large measure, that is exactly what happens. We write specifications that are geared to try to protect us from companies who would sell less than quality merchandise to us. And we frequently include enough detail that we then force out of the competition some of the very best producers.[4]

b. Examples of overspecification

There are two basic types of overspecification. First, DOD frequently overstates (or goldplates) its requirements, by requiring a more elaborate product or a higher performance than it actually needs. Second, DOD often states its requirements in extreme detail, specifying even the minutest details of what the product should look like. Both types of overspecification—overstated requirements and overly detailed requirements—have the effect of disqualifying NDI's which would otherwise meet DOD's needs.

In some cases, DOD establishes requirements that go beyond what it actually needs. As a result, products that have proven their reliability in the commercial market or through extended use by agencies of the U.S. or allied governments have been deemed unacceptable for use within the DOD without extensive modifications.

For example, the Air Force recently refused to purchase an automatic parachute release mechanism that has an accident-free

[4] Hearing Record, p. 79.

record in extensive use by the Air Forces of Canada, West Germany, Italy and Spain. Instead the Air Force entered into a developmental contract for an entirely new release mechanism at approximately three times the cost of the proven device and at a high performance risk. The level of risk involved in this procurement must be considered high in light of the fact that the Air Force was unsuccessful in a previous attempt to procure an identical device through a developmental contract.[5]

The Air Force argues that the existing device does not meet all of its needs.[6] Yet, despite repeated inquiries by the Subcommittee staff, the Air Force has yet to produce any document showing where these requirements came from, or how the Air Force justified the need for these requirements and the resulting expense.

Similarly, Robert Rossow of Midland Brake, Inc. of Owosso, Michigan testified at the Subcommittee's May 16, 1989, hearing that DOD has substantially overstated its needs for packaging of common brake parts. Mr. Rossow cited as an example DOD's requirement that a five cent O-ring seal be packaged in a two-dollar air-tight box. When this flexible, sturdy part is packaged for normal commercial use, it is simply placed in a plastic bag.[7]

Mr. Rossow also described instances in which DOD required manufacturers to package hydraulic brake boosters in foam-in-place packaging, which costs about ten dollars more than the commonly used heavy duty waterproof boxing. It also doubles the size of the box, which increases both shipping and storage costs. The parts van in which these parts are normally stored has very limited storage space. Consequently, the packaging is frequently removed upon arrival and the brake booster stored without any protection. As a result, the government's investment in more expensive packaging results in less protected storage.[8]

In other cases, DOD states requirements in extreme detail in design specifications (some of which are out of date). This, too, has resulted in commerical vendors opting not to compete for the government's business.

For example, the Maine Glove Company of Holton, Maine—a company that makes commercial dress and work gloves—has informed the Subcommittee that it does not bid on DOD contracts. Although the company supplies gloves to civilian agencies of the government, it has determined that it is not worth the cost involved in meeting excessive specifications of DOD contracts.

DOD specifications require the use of a particular type of stitching machine that has been discontinued and is no longer available in the commercial glove industry. In fact, this stitching machine dates back to the 1920's and is used by very few mills in the United States. The Maine Glove Company estimates that it could cut the cost of dress and work gloves by 20 to 30 percent without any loss

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[5] Letter from Irvin Industries, Inc. to Senator Levin, December 29, 1988, Hearing Record, p. 403.

[6] April 26, 1989 letter from the Air Force Office of Legislative Liaison to the Subcommittee. In this letter, the Air Force stated that ". . . the requirement for an automatic parachute release mechanism evolved naturally in life support/egress engineering to improve ejection survivability in high performance aircraft."

[7] Hearing Record, p. 11.

[8] Hearing Record, p. 13.

of quality if the specifications were changed to permit other types of stitching to be used.[9]

The Midland Brake Company has attempted to bid on defense contracts despite this type of restrictive specification, with limited success. According to Mr. Rossow, the Defense Construction Supply Center (DCSC), a subordinate command of the Defense Logistics Agency (DLA), issued a solicitation for wheel cylinders for ultimate use by the Army on its two and a half ton truck. The solicitation was accompanied by a detailed design specification.

Midland Brake, Mr. Rossow's company, responded with a proposal to supply its off-the-shelf part that it had supplied on previous contracts.[10] Midland was informed that, even though it had supplied approximately 180,000 identical wheel cylinders for the Army truck without a single quality deficiency report, its product did not conform to all the details of the solicitation and was therefore unacceptable.[11] The contract was eventually awarded to another company for a higher price than the one quoted by Midland. The ultimate cost to the government will be between $13,000 and $53,000, depending on the number of parts purchased.[12]

c. The CID Program

The use of performance specifications as an effective and efficient way to acquire NDIs, especially commercial NDI's, has been recommended by industry and by numerous studies groups and commissions[13] and has been mandated by the Congress.[14] Performance specifications permit the broadest array of products and companies to compete for the defense dollar, which avails the department of the best that industry has to offer at competitive prices.

In 1977 and 1978, DOD began to draft simplified purchase descriptions under the experimental Commercial Commodities Acquisition Program. As Gregory Saunders, the DOD Assistant for Commercial Acquisition, explained at the Subcommittee's June 1, 1989, hearing, this experiment was an unqualified success:

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[9] Statement of Senator Cohen, Hearing Record p. 2.

[10] The Defense Logistics Agency Congressional Liaison Office confirmed by telephone with the Subcommittee staff that Midland was granted a waiver from the requirements of the specification on previous contracts for wheel cylinders.

[11] The DLA Congressional Liaison Office defended its actions in a telephone conversation with the Subcommittee staff by contending that waivers to design specifications serve to eliminate competition. In fact, however, it is the use of detailed design specifications, rather than performance specifications, that tends to reduce competition. Contractors who have off-the-shelf items that will satisfy the government's need, but which do not conform exactly to the design specification, may not respond to the solicitation because of the hassle involved in obtaining a waiver from the contracting officer. This is especially true with predominately commercial contractors who do not rely heavily on government business.

[12] Statement of Mr. Robert Rossow, General Sales Manager, Midland Brake, Inc. (Hearing Record p. 8) and letter from Midland Brake, Inc. to MG J. P. Dreska, Defense Construction Supply Center, dated December 14, 1988.

According to Mr. Rossow, the difference between Midland's off-the-shelf wheel cylinder and the one described in the specification involves slightly different measurements of internal components. Nothing is different in terms of form, fit, or function; the overall dimensions are the same and the parts of the device that connect to the truck are identical. Moreover, the internal workings of the wheel cylinder have been proven in both commercial and military applications for years.

[13] Report of the Defense Science Board's Task Force on Specifications and Standards (1977); Executive Order 12352, signed by President Reagan in 1982; President's Private Sector Survey on Cost Control (1984); Report by the Georgetown Center for Strategic and International Studies (1986).

[14] Section 907 of the National Defense Authorization Act for Fiscal Year 1987.

During the test, a number of clearly commercial products such as t-shirts, gloves, towels, thermometers, x-ray film, and mustard were purchased "off-the-shelf." The test was an unqualified success with purchases of products that not only were adequate, but in many cases were of better quality than those purchased previously to Military Specifications. In 52 buys worth over 40 million 1976 dollars, there was an average of 2.4 additional bidders per solicitation, end item quality was equal or better in all but a very few cases, prices were lower by 10 percent, deliveries came approximately a monthly earlier, and awards to small business were up by 1 percent, not significant as an increase, but very significant in showing that small business was not harmed by this process.[15]

In light of this success, DOD initiated the Commercial Item Description (CID) program to develop simplified product descriptions to replace detailed specifications. The CID's developed by DOD in this period have two distinguishing features: (1) a simplified description of the product; and (2) the use of a requirement for commercial market acceptability in place of the testing and inspection requirements that are normally included in government specifications. Under the CID program, existing contractors who built products to military specifications and sold only to the government were allowed to continue to do so for three years after publication of a CID for their product.

The Defense Material Specifications and Standards Office (DMSSO) was given the responsibility, within DOD,[16] for developing CID's. In 1979, DMSSO began the time-consuming process of identifying specifications that could obviously be met by commercial products and converting them to CID's. From 1979 to 1982, DMSSO converted approximately 400 specifications to CID's per year.[17]

This progress was abruptly halted after the enactment of a provision in the 1983 Supplemental Appropriations Act prohibiting the use of a commercial market acceptability requirement, if such a requirement would preclude a small business from competing for the contract. This provision was apparently intended to protect small businesses that have developed a market niche building products to meet DOD specifications. Because DOD took the position that there was no point to using CID's without market acceptability requirements, however, this new requirement stopped the CID program dead in its tracks.[18]

In fact, as explained above, CID's contain two separate and distinct parts: (i) the simplified description of the product, and (ii) the use of market acceptability to assure quality and reliability. The need to convert design specifications to performance or functional specifications for commercial products is valid whether or not market acceptability is used to assure quality. For this reason, it would appear that DOD could have continued the CID program with or without the market acceptability requirement. Moreover, the Supplemental Appropriations Act did not prohibit the use of

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[15] Hearing Record at 204-05.

[16] The General Services Administration also develops CID's.

[17] William Garrett Stewart, II (Georgetown Center for Strategic and International Studies), Defense Acquisition of Commercial Products (January 1986) at 11. DOD has developed approximately 1200-1400 CID's; most of them in the 1979-1982 time period. GSA has developed an addition 2000 CID's.

[18] Statement of Mr. Greg Saunders, DOD Assistant for Commercial Acquisition, Hearing Record p. 72.

market acceptability requirements, so long as special provision was made to ensure that small businesses were allowed to compete.

In any case, the "market acceptability" restriction was lifted in 1986. The Appropriations Committee took this step on the basis of an assurance from the Department of Defense that DOD develop a system to ensure that, if market acceptability requirements were used, small business would still be permitted to compete.[19] However, no such system was ever developed,[20] and the CID program was never started again.

Mr. Saunders testified at the Subcommittee's June 1 hearing that the Department of Defense determined that, despite the removal of restrictions from the Appropriations Act, market acceptability requirements remained unlawful under the Competition in Contracting Act (CICA). According to Mr. Saunders—

> Although the restriction [on using market acceptability] was removed in 1986, the Competition in Contracting Act with its emphasis on full and open competition kept us from returning to the practice of requiring commercial market acceptability as a precondition to bidding.[21]

Mr. Saunders testified that a legal opinion developed by DOD lawyers precluded the Department from interpreting CICA in any other way.[22]

Senators Cohen and Levin, the leading sponsors of the Competition in Contracting Act in the Senate, disputed this conclusion at the hearing. As Senator Cohen explained:

> Senator COHEN. It really caught my attention when, in page 3 of your statement, you indicated once this restriction was removed, the Competition in Contracting Act, with its heightened emphasis on full and open competition, has kept us from returning to the practice of requiring commercial market acceptability as a condition of bidding.
>
> And my reaction, [is] that is just sheer nonsense. That is absolute nonsense. That was never the intent of the CICA Act. The purpose of the CICA Act is, say you have got too many sole-source contracts out there and it is time to get more competition, and we are still going to allow some exemptions. The emphasis is on competition, some exemptions. When DOD, for example, has some unique products it needs, some unique aspects, that are not commercially available, that is when you can go back to a sole-source contract.
>
> And you have used that to say we are keeping you from using the market acceptability as a pre-condition for bidding. And there is just no basis in the history of the Act whatsoever.

In fact, the Department of Defense acknowledged in response to a post-hearing question from the Subcommittee that DOD lawyers had not issued a binding legal opinion on this issue. The DOD letter stated that the Department would reexamine the issue and renew its efforts to issue streamlined functional specifications:

> There is no written legal opinion on the relationship between market acceptability requirements and the Competition in Contracting Act (CICA). There has been a widely held recognition that CICA allows restrictions in specifications, provisions or conditions, only to the extent necessary to satisfy the needs of the agency or as authorized by law. This has precluded limiting offers to commercially available items. In view of [the comments of Senators Cohen and Levin] at the hearing, we are preparing a clarifying memorandum for the signature of the USD(A) to help promote wider use of commercial market acceptability.

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[19] January 8, 1986 memorandum from Deputy Assistant Secretary of Defense Eleanor R. Spector to Assistant Secretaries for the Military Departments.

[20] February 7, 1989 memorandum from the Defense Logistics Agency to the DAR Council.

[21] Hearing Record, p. 72.

[22] Hearing Record, p. 86.

d. DOD review of specifications

Even before the Subcommittee's hearings, the Department of Defense had begun to recognize the problems caused by overspecification. In a November 1988 report to the Secretary of Defense, Under Secretary Robert Costello reported that:

> Government specifications and standards have been criticized for being obsolete, overage, overly restrictive, and not conducive to commercial acquisition. While some of this criticism is unjustified or misdirected, there is ample room for improvement. A review of the Department of Defense Index of Specifications and Standards demonstrates there are about 7,200 overage documents for which appropriate corrective action has not been initiated; there are duplicative documents that could be combined or eliminated; there are military specifications and standards that could be replaced by non-Government standards or commercial item descriptions; there are several documents that have been in interim status for years and need to be fully coordinated; and there are many documents that have been improperly designated as specifications, standards, or some other type of documents.[23]

Unfortunately, DOD's progress in addressing this problem can be described as glacial at best. As early as 1980, a GAO report on DOD's acquisition of commercial products noted that DOD had undertaken the process of reviewing requirements to eliminate obsolete specifications and identify specifications that could be replaced by commercial item descriptions. As GAO noted, little progress was being made:

> DOD's specification improvement program will not meet the commercial products policy milestones. At the rate specification preparing offices are working, it will be many years before DOD's 40,000 specifications, standards, and handbooks are reviewed. Also, results of reviews conducted so far indicate that few changes will be made by specification preparing offices.[24]

As Mr. Costello explained in his November 1988 Report, DOD simply has not placed a high enough priority on the simplification of detailed military specifications—

> Department of Defense policies on specifications and standards are often times only paid lip service because each Military Department and Agency seems to lack an office with sufficient authority to enforce implementation of policy. Specification preparing activities are responsive to the goals set by their local commanders, and these do not necessarily support the corporate policy objectives, such as standardization. The excuse is frequently made that there are insufficient resources to implement policy. The resources are available, but as with all programs, there is fierce competition for those resources.[25]

At the Subcommittee's June 1, 1989 hearing, Deputy Secretary of Defense Donald Atwood agreed to address this problem and assign the responsibility for simplifying specifications to a high-ranking official in each service. By letter dated August 10, 1989 Assistant Secretary Jack Katzen informed the Subcommittee that this action

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[23] Enhancing Defense Standardization, Specifications and Standards: Cornerstones of Quality (November 1988) at 21.

[24] General Accounting Office Report #PSAD 80-13, Implementation of Federal Policy on Acquiring and Distributing Commercial Products is Faltering Badly (January 14, 1980) at 10.

Senator Levin pointed out at the Subcommittee's June 1 hearing that DOD had reviewed and revised a 37-page military specification for residential heat pumps—and managed to shorten it from 37 pages to 36 pages. Hearing Record, p. 53. See Specification MIL-H-22547B(YD) (July 16, 1976); MIL-H-22547B(YD) (August 2. 1988). The commercial manufacturer who provided the Subcommittee with these specifications told the Subcommittee staff that its commercial products would meet the Department's needs, but could not possibly comply with the detailed specifications.

[25] *Id.* at 20.

had been taken. The letter also contains a new timeline for reviewing and simplifying military specifications.[26]

2. CONTRACT TERMS AND CONDITIONS

The second impediment to the acquisition of NDI's is inappropriate and inconsistent use of contract terms and conditions in defense contracts. While each such contract clause may be easy to include in a contract, each costs time and money to the contractor and ultimately to the government. When they are imposed needlessly, they can result in substantial waste.

The evolution of contract clauses has paralleled the evolution of specifications. Over the years, many new contract clauses have been developed to refine the government's business practices or correct perceived problems or abuses in the contracting system.

At the present time there are 487 contract clauses in the FAR and 432 clauses in the defense supplement to the FAR that may be included in defense contracts. In addition, numerous other clauses are routinely incorporated into contracts by the military services and individual purchasing commands.

a. Inappropriate contract clauses

The industry witnesses at the Subcommittee's May 16, 1989, hearing testified that numerous contract clauses included in DOD contracts for commercial products contain requirements that are inconsistent with commercial business practices, leading to added costs for the contract and the government.

Some of these problematic clauses are mandated by statute to promote non-procurement goals of the federal government. For example, the statutes creating set-aside programs for small business, minority, handicapped and disabled contractors specifically require the inclusion of contract clauses in covered contracts. Similarly, a number of statutes—such as the Buy American Act—create trade preferences that are implemented through contract clauses.

These statutorily mandated contract clauses have been deemed necessary by Congress because the federal government is not just another purchaser attempting to obtain the best possible product at the lowest possible price. Rather, the federal government has a number of social and economic goals whose benefits are judged to outweigh the added costs such contract clauses may impose upon the procurement system.

Numerous other burdensome clauses are not required by statute at all, or have been given much broader application by DOD than would be required by statute. Many of these contract clauses—such as subcontract approval requirements, patent clauses, reconditional material requirements, and defense production priority requirements—appear to have been developed for use in large, flexibly priced contracts for military-unique products, but have nonetheless been applied to many commercial contracts.

In some cases, commercial contractors who are confronted with these requirements decide to walk away from government business

[26] August 10, 1989 letter from Assistant Secretary of Defense (Production and Logistics) to the Subcommittee.

altogether. For example, John Fluke of John Fluke Manufacturing Company testified at the Subcommittee's May 16, 1989 hearing that his company refused to bid on a solicitation for a government purchase of two hand-held multimeters. Multimeters are a standard testing device that Fluke sells in the commercial world for $199.

As Mr. Fluke explained, the solicitation prepared by the prime contractor for this $400 purchase, pursuant to government regulations, was more than a half inch thick. That meant about thirty pages of contract clauses for each hundred dollars in the purchase order—and that didn't even include the dozens of other requirements that were incorporated by reference.

After several attempts, over the course of a year, to persuade the government to apply more reasonable requirements, Mr. Fluke gave up and refused to sell his product to the prime contractor.[27]

Similarly, Naomi M. Williamson, of Honeywell, Inc. testified that her company withdrew its proposal to supply approximately $200 million of commercial avionics to Lockheed for use in the Navy's new antisubmarine aircraft (LRAACA) program. As Ms. Williamson explained, the Department of Defense simply did not have the flexibility to deal with a commercial contractor on reasonable terms—

> The task of reviewing the 88 page Lockheed subcontract was monumental for a Division whose normal contract is less than 40 pages long and does not incorporate by reference a book of fine print regulations, additional special defense regulations, and additional special Navy clauses. We had no one on staff to review the contract who had current knowledge of the entire Federal procurement regulation structure. * * *
>
> We made 83 exceptions or changes to the subcontract because terms were inapplicable, inconsistent with the way we do business, or inconsistent with commercial contracting terms. That means we took exception to mandatory terms right along with the rest.[28]

The routine incorporation of such clauses impose significant costs even when contractors are savvy enough to negotiate for their removal. As the Commercial Product Acquisition Team (COMPACT) explained in prepared testimonysubmitted for the Subcommittee's May 16, 1989 hearing—

> The inappropriate use of clauses also requires the commercial vendor to dedicate time to negotiating with the contracting officer for the removal of such clauses. For example, a commercial vendor must take exception to clauses routinely incorporated into contracts including:
>
> Configuration control—Engineering Changes, Deviations, and Waivers;
> Cost Accounting Standards
> Identification of Sources of Supply;
> Identification of Expenditures in the United States;
> Higher-Level Contract Quality Requirement; and
> Certification of Commercial Pricing.
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> These problems are especially significant for the small businesses that are unable to afford full-time government contract specialists to review the extensive clauses and requirements as well as for the large businesses that must deal with hundreds of different buying offices and hundreds of different contracts and requirements.[29]

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[27] Hearing Record, p. 30.

[28] Prepared testimony of Ms. Naomi M. Williamson, Manager, Contract Management, Business and Commuter Aviation Systems Division, Honeywell, Inc., Hearing Record p. 119, 125-27.

[29] Prepared Testimony of COMPACT, Hearing Record, p. 168.

In Honeywell's case, however, many of the most problematic contract clauses were mandatory, and were not subject to negotiation. As Ms. Williamson explained:

> After we had put together our response and were about to submit our [Best and Final Offer], it finally occurred to us that we might be in for more difficulty than we thought over the commercial contracting issues. We turned for help to our Corporate Contract Management staff and the Office of General Counsel, a resource I doubt most commercial contractors have. Of course, when they read through the list of exceptions we had taken, they raised a red flag. They advised that Lockheed could not do what we had asked them to do—not if the procurement was to be accomplished pursuant to the Federal Regulations. There is no such thing as a "commercial contract" exemption under the existing regulations. We also hired outside counsel to advise us and got the same answer.[30]

As a result, Honeywell dropped its bid and withdrew from the program.

The LRAACA program manager at Lockheed informed the Subcommittee staff that Honeywell was a strong competitor to supply the entire avionics system, including system integration. In the case of two of the system components, the color weather radar and the passive weather avoidance components, Honeywell's products were technically superior to anything else on the market. As a result of Honeywell's withdrawal, Lockheed will now have to procure individual components of the avionics system from several contractors, set up its own integration laboratory, and perform system integration itself.

This process will likely lead to increased cost and schedule delays. Because Lockheed's contract with the Navy is a fixed price incentive contract, the Navy will pay for a substantial percentage of any resulting cost overruns.[31] Moreover, in the case of the color weather radar and the passive weather avoidance components, the Navy will not be able to get the latest available technology, which is produced only by Honeywell.

b. Inconsistently used contract clauses

A second problem faced by commercial contractors trying to do business with the government is the near-random manner in which clauses are selected for inclusion in contracts. As DOD itself explained in its draft NDI report in 1987:

> [I]nconsistent contract clauses used by different government agencies, different Departments and Agencies within the DOD, and different buying organizations within a Department or Agency cause confusion and uncertainty and increase a contractor's risk in doing business with the Government.[32]

DOD has never published guidance on the clauses that are appropriate for inclusion in commercial contracts and subcontracts. Contracting officers are usually provided a list of clauses covering every conceivable contracting situation from which to select those that should by included in a particular solicitation. Absent clear guidance in this area, contracting officers frequently take the cautious approach by erring on the side of too many clauses, placing the burden on contractors to justify removal of specific clauses.

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[30] Prepared testimony of Ms. Naomi M. Williamson, Manager, Contract Management, Business and Commuter Aviation Systems Division, Honeywell, Inc., Hearing Record p. 127.

[31] Telephone conversation with Mr. Lyle Schaefer, Program Manager, LRAACA Program, Lockheed, August 16, 1989.

[32] Draft DOD Report, Hearing Record, p. 233.

In preparation for the May 16 Subcommittee hearing, the Subcommittee staff examined six DOD solicitations for commercial oscilloscopes—three from the Navy, two from the Air Force and one from the Army. The staff found that 171 different contract provisions were included in at least one of the six solicitations. Of these contract clauses, only 27 were included in all six, an additional 14 were included in five of the solicitations; 16 were included in four of the solicitations; 37 were included in three of the solicitations; 37 were included in two of the solicitations; while 40 were unique to one of the solicitations—and this was for the purchase of the very same item.

Subsequent to the hearing, the staff reexamined the issue to determine whether these results were caused by unique circumstances in the solicitations. Accordingly, the staff provided an identical hypothetical situation to one contracting officer from each of the services and asked for a list of the contract clauses that would be applied. The hypothetical contract was as follows:

Product: Commercial, off-the-shelf oscilloscope.
Contract Price: $750,000.
Type of contract: Firm-fixed-price.
Full and open competition.
Award based on adequate price competition.

The same massive inconsistencies resulted. The Air Force version of the contract included 107 standard clauses; the Navy version 85 standard clauses; and the Army version 99 standard clauses. Of the 140 clauses that were used by at least one of the three contracting officers, only 58 were used by all of them and 32 were used by two of the three, while 51 clauses were unique to the contract prepared by one of the three services.

Moreover, these numbers do not even include: (a) clauses relating only to the submission of bids and proposals; or (b) "local clauses" imposed by individual commands within each service. The Air Force contracting officer listed an additional 29 local clauses; the Navy contracting officer an additional 33 local clauses; and the Army contracting officer an additional 35 local clauses.

The Department of Defense attempted to address this problem more than six years ago, but unfortunately nothing came of the effort. On March 21, 1983, DOD issued a proposed regulation listing the clauses to be used in contracts for the acquisition of commercial products.[33] The proposed regulation identified 23 clauses that are required in commercial contracts and 52 clauses that should be included when applicable. Unfortunately, this proposed regulation was never acted upon. Consequently, contracting officers have been left to determine on a case-by-case basis which clauses are appropriate, with inconsistent results.

c. Flowdown requirements

The problems caused by the use of inconsistent and inapplicable contract clauses in contracts for commercial products are compounded by the fact that many of these clauses are required to be "flowed down" to subcontractors. Subcontractor flow-down signifi-

[33] Reprinted in Federal Contracts Report, Vol. 39, March 21, 1983, p. 677.

cantly increases the number of companies that are affected by such clauses and makes it even more difficult for commercial manufacturers to do business with the government.

Dan Pinick, Senior Vice President of the Boeing Company, testified at the Subcommittee's May 16, 1989 hearing that DOD requirements to flow down contract clauses to subcontractors make it very difficult for the company to bid on DOD contracts. As Mr. Pinick explained—

> Many suppliers to the Boeing Commercial Airplane [Company] are commercial companies who do no business with the Government. . . . [These companies] are accustomed to operating only in the commercial world using commercial business arrangements and are not inclined to reorganize themselves to do business with the United States Government.
>
> Now, under the current Government acquisition system, when we receive a contract for commercial aircraft, there are many Government peculiar terms, conditions and specifications that are required to flow down to subcontractors, vendors and suppliers. . . . In some cases, such as cost or pricing data, there are exemptions that may be available for commercial products. However, qualifying for these exemptions is often difficult and, as a practical matter, may not be available. Moreover, the myriad remaining clauses and Government specifications are generally unacceptable to our commercial suppliers because they are organized to produce and sell their products using commercial business arrangements.
>
> These flow down requirements are a particular problem because of the way in which commercial programs are developed. In a commercial environment, the selection of sources and the acquisition process for raw materials, parts, subassemblies, and components is set in motion and often completed well in advance of the orders being placed by our commercial customers.
>
> The Government order for an airplane containing flow down requirements cannot, therefore, in many instances, be complied with after the fact by our vendors and suppliers. . . . Furthermore, the problem does not end with the delivery of the aircraft. It continues for many years because of the Government's spare parts requirement[s] to support the aircraft.[34]

In the case of the LRAACA program, Boeing offered to supply the Navy a modified version of its 757 commercial jet, which had been available commercially for ten years. Boeing believed that because the 757 met or exceeded the Navy's operational requirements and was already a proven aircraft, the use of this aircraft would yield significant savings to the government. Because Boeing's network of commercial suppliers supporting the 757 program was firmly established, however, the flowdown of contract clauses to satisfy DOD requirements would have required Boeing to renegotiate approximately 3900 vendor contracts—an almost impossible task.[35]

Boeing did not win the LRAACA contract and was never required to renegotiate its vendor contracts on this program. However, similar problems are currently hampering the company's efforts to supply needed spare parts for the AWACs system and the Air Force One Presidential aircraft.[36]

Subsequent to the hearings the Department of Defense informed the Subcommittee that it has initiated an effort to review the flowdown of all clauses.[37]

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[34] Hearing Record, pp. 15–16.

[35] Statement of Mr. Dan Pinick, Senior Vice President, The Boeing Company, Hearing Record, p. 16.

[36] Hearing Record, pp. 15, 23–24.

[37] August 10, 1989 letter from Assistant Secretary of Defense for Procurement and Logistics to the Subcommittee.

d. The defense priorities allocation system (DPAS)

One specific example of a contract clause that has caused problems for commercial contractors is the contract priority clause implementing DOD's defense priorities and allocation system (DPAS). This clause, which is required in all DOD orders over $500 and all subcontracts under such orders—literally millions of contracts—requires the manufacturer to give priority to DOD production over any other production.

The DPAS system was instituted pursuant to the Defense Production Act of 1950, 50 U.S.C. 2061, which authorizes DOD to require priority production where necessary. The Act authorizes the President—

> * * * to require that performance under contracts or orders . . . which he deems necessary or appropriate to promote the national defense shall take priority over performance under any other contract or order, . . . and to require acceptance and performance of such contracts or orders in preference to other contracts or orders by any person he finds to be capable of their performance.

Willful violation of the DPAS system is a criminal offense.

Al Herman of Tektronix, Inc. testified at the Subcommittee's May 16, 1989 hearing that DOD's blunderbuss approach to implementing the DPAS system has substantially disrupted his company's production of commercial products without any evidence that there was a real need for priority production of DOD requirements. As Mr. Herman explained:

> [L]ack of clear regulatory guidance permits virtually unrestricted use of the DPAS rating system. Most of the DOD orders which we get are DPAS rated. We recognize that national defense is a high priority.
>
> However, unnecessary and unlimited use of the DPAS ratings require us to develop special and costly order processing procedures, establish special buying requirements, shift production schedules, and delay delivery to commercial customers. This is particularly troublesome when a priority rating is used in cases where the product is destined for storage in a government warehouse.[38]

Subsequent to the Subcommittee hearings, DOD officials agreed to reexamine the DPAS system and determine whether it would be possible to ensure that priority production is required only when it actually is "necessary or appropriate to promote the national defense."

3. CERTIFIED COST OR PRICING DATA

Another major impediment to the acquisition of NDI's is the requirement in the Truth In Negotiations Act (TINA) that contractors submit certified cost or pricing data to the government. Under TINA, certified cost or pricing data is required on all negotiated contracts, subcontracts and modifications to contracts which exceed $100,000.

a. Background

Cost or pricing data is detailed documentation of how much it costs to build a product. The term is defined as "all facts that, as of the date of agreement on the price of a contract (or the price of a contract modification), a prudent buyer or seller would reasonably

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[38] Statement of Mr. Al Herman, General Manager, Federal Systems Division, Tektronix, Inc., Hearing Record, p. 38.

expect to affect price negotiations significantly. Such term does not include information that is judgmental, but does include the factual information from which a judgment was derived."[39] In practice, cost or pricing data include (a) all purchase orders, vendor quotes, and other information about material prices, (b) information about labor hours incurred on comparable or predecessor contracts, (c) information about current and projected labor rates, and (d) information about current and projected overhead costs.

This information must be current, accurate, and complete up to the time the contract is entered. It must also be auditable. This means that the contractor has to have special systems in place to record all of this data and make sure that it is provided to the government in a timely manner. It also means that contractors must have administrative staff available to interpret the rules that have a bearing on cost or pricing data, such as the allowability of costs on government contracts.

Few commercial manufacturers are equipped to track these costs in the detail required by the government; many believe that they would price themselves out of the commercial marketplace if they were to develop and maintain the accounting systems necessary to do so. This is one reason why a number of aerospace companies have spun off separate divisions for commercial and military sales. For small commercial companies, the choice is more limited; many cannot afford to pursue business with DOD at all if they are required to provide cost or pricing data.

Cost or pricing data is used by the government to perform "cost analysis," an analysis of whether the contractor's price is based on the real and proper costs that will actually be incurred on the contract. Cost analysis is one method of determining if the contractor's price is reasonable. It is not the best method, however, because even if a contractor can prove that it will spend as much on a contract as it says it will, this doesn't mean that the job couldn't be done for less.

In general, the government has far better assurance that prices are reasonable when competition is present (either in direct sales to the government or in sales of comparable products in the commercial market). However, cost analysis is a essential method of testing the contractor's price when competition is impossible—as when the government buys a unique item, such as a submarine or a fighter aircraft, on a sole source basis.

The Truth In Negotiations Act recognizes that competition provides greater assurance that a contractor's price is reasonable than cost analysis by providing that cost or pricing data need not be required when the price is based on (a) adequate price competition; or (b) catalog or market prices of commercial items sold in substantial quantities to the general public. These two exemptions are intended to relieve commercial companies of the requirement to submit cost or pricing data when bidding on contracts to supply commercial products.

Unfortunately, these exemptions have been so narrowly construed in practice and in the regulations that substantial problems

[39] Truth In Negotiations Act, 10 U.S.C. 2306a(g).

remain. These problems include: (a) the failure of some contracting officers to grant exemptions in competitive contracts; (b) the rigid percentage requirements for determining whether a product qualifies for the commerciality exemption; (c) the application of this exemption to new products, old products, and modified products; and (d) the application of either exemption to spare parts and change orders.

b. The competition exemption

The problem with the first exemption, for contracts based on adequate price competition, is that the exemption is discretionary. Industry witnesses at the Subcommittee's May 16, 1989, hearing testified that contracting officers who are overly cautious and afraid of making a mistake frequently require cost or pricing data in competitive procurements.

In one case described by John McGowan of the Hewlett Packard Company at the Subcommittee's May 16, 1989 hearing, more than 100 companies attended a pre-solicitation bidders' conference held by the Army in a procurement for computers and communications equipment. Despite this obvious competition, Mr. McGowan testified, the contracting officer insisted on requiring all bidders to submit cost or pricing data.[40]

As COMPACT explained in written testimony submitted to the Subcommittee, this requirement places a heavy paperwork burden on commercial contractors, even if they are ultimately permitted to compete:

> Such a request places the commercial vendor in the same unenviable position of having to refuse the business, comply with the request, attempt to negotiate with the contracting officer and seek the elimination of the request, or submit a 1412 [detailed information to support a request for exemption.][41]

According to Mr. McGowan, this process requires his company to maintain full-time staff to prepare and support audits of [requests for exemption]. In addition, much time is spent training and negotiating with employees and customers over the requirements for these requests.[42]

c. Percentage requirements

There are numerous problems with the second exemption, based on commercial pricing. The first is that the regulations set forth strict percentage requirements that a product must meet over a representative sales period.

Under the regulations, a contractor must provide sales data for the most recent monthly, quarterly, or other period for which sales data are reasonably available. To qualify for the exemption, the contractor must demonstrate that 55 percent of the total sales of the product were sales to the general public and that 75 percent of these sales were made at catalog prices. Contracting officers may grant exemptions in cases where the sales percentages fall slightly below the thresholds, but are not required to do so.[43]

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[40] Hearing Record, p. 32-33.
[41] Hearing Record p. 160.
[42] Hearing Record, p. 46.
[43] FAR 15.804-3(f)(2).

In many instances, these strict percentage requirements simply don't make sense. In some cases, strict adherence to the rules results in situations that just don't make sense. The purpose of the commerciality test is to provide assurance that the product has been subjected to the forces of competition in the commercial marketplace—and in particular to the downward pressure on price that occurs naturally through repeated competitve sales. However, the percentage requirements preclude consideration of many products that would meet the purpose of this test.

For example, a product may be sold in substantial quantities in a highly competitive commercial marketplace, but not meet the percentage requirements because a single large government purchase skews the company's sales data. For example, the Electronic Industries Association (EIA) described a case in which sales had traditionally been split 80 percent to the general public and 20 percent to the government. A single buy by the Air Force of 8,000 units reversed the split in sales so that the product no longer met the percentage requirements in the regulation.[44]

Similarly, COMPACT described a case in which the Navy rejected a contractor's request for exemption, because the Army had recently purchased a large number of the same commercial product—raising the percentage of government sales from 9 percent to over 56 percent.[45] In each case, the company's commercial sales, subject to market pressures, were no less than they had been before, but the company no longer qualified for the exemption.

Moreover, for purposes of the percentage tests in the regulation, competitive sales to the government are not counted as competitive sales, even though the price is market-based. As a result, a company could sell its product competitively to both the commercial market and the government (never once selling on a sole-source basis) and still not qualify for an exemption from the requirement for cost of pricing data.

d. New, outdated, and modified products

The percentage test has additional problems when it is applied to specific types of products, such as new products, outdated products, and modified products.

In the case of new products, many contracting officers require a full year of sales before granting an exemption. Moreover, to qualify as a sale, a product has to be delivered; a contracted sale without delivery is not good enough. This means that a very lengthy sales history must be compiled before a product can qualify for the exemption, making it very difficult for many commercial contractors to sell their latest technology products to the government.

Al Herman of Tektronix, Inc., testified on this problem at the Subcommittee's May 16, 1989 hearing. According to Mr. Herman, Tektronix spent several months convincing the government that certain specialized cable test products met the requirements for a commercial exemption. By the time the exemption was actually granted, however, an upgraded version of the product was in commercial production. DOD decided that it wanted the upgraded ver-

[44] Written Testimony of the Electronic Industries Association, Hearing Record p. 416.
[45] Hearing Record, p. 161.

sion of the product, but ultimately had to wait seven months until adequate sales data had been accumulated to meet the commerciality test.[46]

Similar problems are encountered by sellers of outdated products. In many cases, DOD continues to buy a commercial product long after commercial customers have moved on to an upgraded version of the product. Even though the original product has a long history of commercial sales, these sales are no longer reflected in the company's sales figures for the most recent sales periods. As a result, the company may eventually lose its exemption because it can no longer demonstrate substantial sales of the product to the general public.

For example, EIA's written testimony describes a case in which a commercial company manufactured thermal printers driven by large computers. Technological capabilities changed and these thermal printers became obsolete. While commercial customers moved to the new technology, the government continued to buy thermal printers for replacement purposes and to meet overall systems design specifications based on long lead times. Once commercial sales dropped below 35 percent of total sales, the product no longer qualified for exemption from submission of certified cost or pricing data. This made it extremely difficult for the producer to continue to meet the government's needs—even though there was a lengthy history of commercial sales.[47]

Finally, in the case of modified products, the regulations state that an exemption may be granted to a product that is "similar to" a commercial product, only if the products are so similar that cost analysis is not required to identify and justify differences in price.[48] As Naomi Williamson of Honeywell pointed out in her testimony for the Subcommittee's May 16 hearing, this determination is at the discretion of the contracting officer (and the auditor).[49]

In fact, as Ms. Williamson explained in response to a question from Senator Levin, a company may have a product that qualifies for the commercial exemption, but lose the exemption because it modifies the product at the request of the government:

> Senator LEVIN. If you were able to obtain an exemption to sell a part to the DOD to begin with, [but] you modified [the] part at the request of the DOD, could you lose that exemption?
>
> * * * * * * *
>
> Ms. WILLIAMSON. Yes. Yes, distinctly.[50]

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[46] Hearing Record, pp. 35-36. The Aluminum Company of America (ALCOA) states in written testimony submitted for the record (Hearing Record, p. 422) that it has also experienced difficulties in selling its most advanced products—aluminum alloys developed at ALCOA's expense—to DOD because these new products do not qualify for exemption from the requirement for cost or pricing data.

[47] Hearing Record p. 416. In the end, the requirement was apparently circumvented by limiting sales to contracts under the $100,000 threshold for the submission of cost or pricing data. When this approach is taken, the government may end up making the purchase without any information at all about the seller's prices.

[48] FAR 15.804-3(c)(6).

[49] Hearing Record, p. 25.

[50] Hearing Record, p. 25.

e. Contract modifications and spare parts

Even when a company meets the test for a competitive or commercial exemption under the Truth in Negotiations Act, it may ultimately have to provide cost or pricing data to the government when the contract is modified, or the government purchases spare parts. This situation not only makes it difficult for DOD to buy the spares it needs, but discourages some commercial companies from doing business with DOD in the first place.

With regard to contract modifications, there is virtually no possibility of getting an exemption when the Truth in Negotiations Act applies. The competition exemption is not available because a contract modification to an existing contract cannot be competitively awarded; the commercial products exemption is rarely available, because most contract modifications are based on unique DOD demands.

This problem is aggravated by an over-inclusive regulatory implementation of the Act. In general, the Truth in Negotiations Act requires a prime contractor to submit certified cost or pricing data in connection with contract modifications that exceed $100,000 (assuming that no exemption is available). Subcontractors are required to submit cost or pricing data in connection with contract modifications exceeding $100,000, but only if the subcontractor was required to submit cost or pricing data in connection with the subcontract.[51]

In other words, if the subcontractor was not required to submit cost of pricing data in connection with the original subcontract, then it is not required by law to submit cost or pricing data in connection with a modification.

Despite this clear limitation on TINA's applicability, however, the contract clauses that DOD uses pursuant to the Federal Acquisition Regulation, however, require cost or pricing data for any subcontract modification exceeding $100,000 (again, assuming that there is no applicable exemption) in all cases, regardless of whether cost or pricing data was required by the initial contract.[52]

This is not an academic difference. Honeywell was a potential subcontractor on the LRAACA program that would almost certainly have qualified for an exemption to cost or pricing data requirements on its initial subcontract. Yet, Ms. Williamson testified at the Subcommittee's May 16 hearing that the possibility that Honeywell might be required to submit cost or pricing data in connection with contract modifications played a major role in the company's decision to withdraw its bid on the program.[53]

Similarly, in the case of spare parts, a company that is exempt from cost or pricing data requirements on the original contract may be required to provide such data in connection with spare parts contracts. This is because DOD frequently purchases different types of spare parts than commercial users of the same product, so the parts may not have a history of commercial sales, even though

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[51] 10 U.S.C. 2306a(a)(D).

[52] FAR 15.804-8 (d).

[53] Statement of Ms. Naomi M. Williamson, Manager, Contract Management, Business and Commuter Aviation Systems Division, Honeywell, Hearing Record p. 20.

the underlying product does. As EIA explained in its testimony for the record:

> Assemblies containing repairable components of commercial test equipment are not normally repaired by commercial users by replacing individual components. The commercial users usually buy maintenance and service contracts that result in sales of modular replacements being buried in repair orders and consequently, not easily traceable. DOD relies on the use of modular replacement units where the entire circuit board is replaced in the field but then the defective board is sent to a depot for repair. Because the entire circuit board, although priced in a catalog, is rarely sold to commercial users, the circuit board does not meet regulatory definition of "substantial quantities."[54]

In fact, Al Herman of Tektronix, Inc. testified at the Subcommittee's May 16, 1989 hearing that there have been instances in which DOD buys the entire product, unassembled, in order to obtain spare parts—because the product meets the commerciality test, but the parts do not.[55] Although Mr. Herman was reluctant to reach any conclusion about the purchasing practice involved, it appears likely that at least some of the parts acquired through this purchasing method are not needed, and may even have been discarded, by DOD.

Deputy Secretary of Defense Donald Atwood testified at the Subcommittee's June 1, 1989, hearing that he understood these problems and would work to ensure that the Department of Defense buys commercial products by relying on price analysis techniques (rather than cost or pricing data) to the maximum extent possible. In particular, Deputy Secretary Atwood stated that the Department would consider new regulations that would address the problems of overly rigid percentage requirements and their application to new and discontinued commercial products. According to Mr. Atwood, this change should "streamline and simplify the current requirement, yet still be in compliance with the requirements of the Truth in Negotiation Act." [56]

4. QUALITY ASSURANCE AND WARRANTIES

The final impediment identified by the industry witnesses at the Subcommittee's May 16, 1989 hearing is DOD's rigid approach to quality assurance and, in particular, on-site inspection provisions in DOD contracts. As COMPACT explained in a report issued in August 1987—

> Those Government inspections and quality control programs only serve to add additional inspection and quality control paperwork burdens to most well-established commercial vendors who must be concerned with the reputation and actual quality of their products in a highly competitive commercial marketplace. As a result, the additional Government requirements only add to the cost of such products without providing any benefit to the Government.[57]

The report cited an example of a COMPACT member company which devoted an average of 14 hours of staff time each week to inspection visits, yet the company never had a single rejection of any product based on the inspections. Al Herman of Tektronix, Inc.

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[54] Hearing Record, p. 416.
[55] Hearing Record, p. 40–42.
[56] Hearing Record, p. 201.
[57] "Commercial Product Acquisition, Current Impediments and Recommendations for Improvement," prepared by the Commercial Product Acquisition Team (COMPACT), August 1987, p. 40–42.

made the same point in his testimony at the Subcommittee's May 16, 1989, hearing:

> Successful commercial companies have strong commitments to meeting the quality requirements of their commercial customers, both domestic and international. * * * The quality control process and documentation requirements of the Government are largely redundant with our commercial quality control process. Moreover, we believe that marginal or no added benefit is achieved as a result of the Government inspection process.[58]

Instead of imposing these extensive quality control procedures on commercial contractors, Mr. Herman suggested, the government should make greater use of commercial warranties. Mr. Herman explained that these warranties offer benefits not only to the government, but also to the commercial manufacturer:

> Although warranty work increases the manufacturer's costs for a particular product, it has several benefits. It provides the manufacturer with critical information about product failures so that improvements can be made. It permits repairs to be made properly and more quickly with the right equipment and trained technicians. It reduces the number of products being returned to the user with improper repairs, thereby reducing customer dissatisfaction with the product. And it provides the commercial vendor with an opportunity to market its maintenance services which often provide a more cost-effective way for customers to maintain their equipment.[59]

Despite numerous DOD policy statements in favor of warranties, however, Mr. Herman testified that "relatively little use of them seems to be occurring." [60]

In response to questions from Senator Levin, Mr. Fluke agreed that DOD could meet its quality needs without imposing needless inspection requirements on contractors, if it would make more use of commercial warranties. However, Mr. Fluke stated that the DOD system simply is not set up to take advantage of commercial warranties:

> Senator LEVIN. If the DOD made greater use of warranties, would we be able to avoid some of that excessive rulemaking that guides these inspections?
> Mr. FLUKE. Absolutely.
>
> * * * * * * *
>
> Senator LEVIN. What is there missing? Is it something that tilts against warranties or is it just pure inertia?
> Mr. FLUKE. * * * I think it is the fact that the regulations simply do not recognize the possibility of a supplier coming to its customer and saying, customer, I commit to supplying this product in good working order that will meet or exceed its specifications and it will do so for some period of time—90 days, a year, or 3 years, whatever the warranty may be.
> The system cannot recognize that and accept it as a feature of the product.[61]

At the Subcommittee's second hearing, on June 1, Mr. Atwood agreed with the industry witnesses that DOD inspection procedures sometimes impose unnecessary burdens on commercial contractors. In the future, DOD intends to place greater reliance on contractor inspection for commercial and off-the-shelf, noncritical items. The new policy, Mr. Atwood stated, should "virtually eliminate the additional cost and the inconvenience that are incurred when commercial contractors must make changes to their standard proce-

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[58] Hearing Record, p. 37.
[59] Hearing Record, p. 188.
[60] Hearing Record, p. 37.
[61] Hearing Record, p. 48.

dures in order to satisfy the Government inspection requirements." [62]

On the other hand, Mr. Atwood stated that most commercial warranties are not sufficient alone to protect the government's interest in a quality product:

> The scope of the normal commercial warranty is simply not inclusive enough to ensure quality. They warrant against defects in materials and workmanship; they do not guarantee performance of the item, nor do they guarantee the quality of any item upon production. Warranties also place a number of burdens on the buyer, such as transportation and administration.[63]

5. FINDINGS AND RECOMMENDATIONS

a. Product descriptions and specifications

Finding No. 1

The Department of Defense practice of overstating requirements precludes the Department from benefitting from the purchase of existing systems and results in unnecessary expenditures of both time and money developing new systems.

Recommendation

The Department of Defense should ensure that its agencies procure NDI's when such products will fulfill agency needs. Prior to entering into a developmental contract for a product which has an NDI counterpart, an agency should conduct and document a thorough analysis of the impact of developing a new product on the cost, schedule and performance of the contract. The developmental item should be procured only if it is clearly shown that the NDI is inadequate to fulfill the minimum needs of the agency.

Finding No. 2

The Department of Defense has made inadequate progress in stating its needs in terms of (i) functions to be performed, (ii) performance required, or (iii) essential physical characteristics. The Department's practice of stating requirements in extreme detail discourages many contractors from even bidding on defense contracts.

Recommendation

The Department of Defense should intensify its efforts to review existing specifications and standards, replace design specifications with performance specifications, and adopt nongovernmental standards and specifications whereever possible.

Finding No. 3

The Department of Defense unnecessarily abandoned its effort to replace military specifications with simplified commercial item descriptions.

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[62] Prepared Statement of Mr. Atwood, Hearing Record, p. 199.
[63] Prepared Statement of Mr. Atwood, Hearing Record, p. 199.

Recommendation

The Department of Defense should revitalize the commercial item description (CID) program.

b. Contract terms and conditions

Finding No. 4

The Department of Defense continues to impose inappropriate and burdensome contract requirements in contracts for commercial products. This practice discourages many commercial manufacturers from bidding on DOD contracts.

Recommendation

The Department of Defense should revise regulations that require unnecessary and burdensome contract clauses in contracts for commercial products.

Finding No. 5

Different components of the Department of Defense use different and inconsistent contract clauses for the purchase of commercial products. This practice causes confusion and uncertainty and discourages commercial manufacturers from doing business with the government.

Recommendation

The Department of Defense should ensure consistent and predictable requirements in contracts for commercial products by establishing a list of only those contract clauses that are required for inclusion in such contracts and permitting the use of other clauses only upon a determination by the contracting officer that a clause is essential for the protection of the government's interest in that procurement.

Finding No. 6

The Department of Defense requires that burdensome contract clauses be flowed down to subcontractors in commercial contracts. In some cases, this requires commercial manufacturers to re-open existing contractual relationships with subcontractors, which some refuse to do. This problem is currently making it difficult for DOD to obtain needed spare parts for some systems.

Recommendation

The Department of Defense should not require the flow-down of contract clauses to subcontractors unless the flow-down of a clause in such subcontracts is required by statute or essential for the protection of the government.

Finding No. 7

The Department of Defense has implemented the Defense Production Act of 1950 in an overly burdensome and excessive manner, requiring commercial contractors and subcontractors to give all DOD orders in excess of $500 or more priority over all other production.

Recommendation

The Department of Defense should require priority production of DOD orders only when such priority production is necessary to promote the national defense.

c. Certified cost or pricing data

Finding No. 8

The Department of Defense regulations implementing the Truth in Negotiations Act unjustifiably require contractors to submit certified cost or pricing data when the government's interest is adequately protected by prices that have been tested in the marketplace. Problems include: (a) the failure of some contracting officers to grant exemptions in competitive procurements; (b) rigid percentage requirements for determining whether a product qualifies for the commerciality exemption; (c) the application of the commercial exemption to new products, outdated products, and modified products; and (d) the application of the competitive and commercial exemptions to spare parts and contract modifications.

Recommendation

The Department of Defense should revise regulations implementing the Truth in Negotiations Act to ensure that contractors are required to submit cost or pricing data in competitive and commercial procurements only when it is necessary to determine whether the contract price is reasonable. In particular, the Department should review the percentage tests established in existing regulations, as well as the applicability of these regulations to new commercial products, outdated commercial products, modified commercial products, and spare parts for commercial products.

d. Quality assurance and warranties

Finding No. 9

Existing inspection procedures of the Department of Defense impose burdens on commercial producers with proven records of quality production. The Department of Defense does not make adequate use of alternative means of ensuring quality, such as warranties, that have proven effective in the commercial marketplace.

Recommendation

The Department of Defense should review its inspection requirements for commercial contracts and work on alternative approaches to quality assurance, such as placing greater reliance on commercial warranties and rewarding contractors with a proven record of quality performance.

B. DOD's Implementation of the NDI Provision

As explained in the previous section, there are still major impediments to the acquisition of NDI's, despite the enactment of Section 907 in 1986. Much of the responsibility for these continuing problems can be attributed to the failure of the Department of Defense aggressively to implement Section 907.

Section 907 required the Department of Defense to identify and remove impediments to the acquisition of NDI's. Within one year of enactment, DOD was required to submit a report to Congress, detailing its progress in implementing the provision.

The Department of Defense prepared a draft report on the implementation of the NDI provision in the fall of 1987. This draft set forth, as required by the legislation, numerous specific statutory and regulatory impediments to increased acquisition of NDI's. Unfortunately, DOD's final report, submitted to Congress in December 1987, deleted much of this material, identifying only five general impediments to NDI acquisition.

A year and a half later, the Subcommittee sent a letter to the Under Secretary of Defense for Acquisition, requesting an update on DOD's NDI report. The Under Secretary responded by letter dated April 21, 1989. From this letter, the Subcommittee learned that DOD had done little to address even the five general impediments to NDI's discussed in the watered-down, final version of its NDI report.

Moreover, despite specific commitments that DOD made in the 1987 report, the Subcommittee learned that—

(a) A promised DOD manual on NDI acquisition still had not been issued;

(b) A promised revision to the DOD Directive on commercial products still had not been promulgated;

(c) A DOD steering group on NDI's had been disbanded;

(d) The single DOD staffer responsible for the NDI program had been assigned so many other duties that he was able to devote only half of his time to NDI's;

(e) Only about 40 minutes in DOD's 20-week training course for program managers had been devoted to NDI's; and

(f) A DOD plan to conduct a series of workshops on NDI's at regional training centers had been canceled.

As Senator Levin explained at the Subcommittee's hearing on June 1, 1989, this record shows a fundamental failure by the Department of Defense to come to grips with the changes needed to increase the acquisition of NDI's. Senator Levin stated:

> The real problem is that despite that [1986] law, the Pentagon remains hooked on the old way of doing business. Instead of recognizing that the commercial products are fundamentally different from military-unique items and require fundamentally different purchasing methods, the Defense Department has tried to buy NDI's by grafting some exemptions and exceptions onto existing rules.
>
> That just does not work.
>
> * * * * * * *
>
> It took us years to change the procurement culture to make competition in procurement the key to reducing cost and improving performance. Senator Cohen and I authored the Competition in Contracting Act and that has helped to finally make some real progress in the area of competition. I am now convinced that it is going to take the same kind of effort to change the DOD culture in the area of NDI's.[64]

The remainder of this section addresses DOD's efforts to address the NDI problem through (1) staffing, training and tracking of the problem; (2) revisions to basic procurement and acquisition regulations; and (3) actions to address specific impediments. In each area,

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[64] Hearing Record, p. 54-56.

the Department has failed to meet basic commitments made to the Congress in its 1987 report.

1. STAFFING, TRAINING AND TRACKING

In its 1987 NDI report, DOD stated that it would: (a) maintain a high-level task force to address NDI problems; (b) maintain a full-time position on the DOD staff on the use of commercial products; and (c) maintain a training course on NDI acquisition for DOD program managers. DOD failed to meet any of these commitments. In addition, DOD has failed even to respond to a request from the Office of Management and Budget that it establish a system to track purchases of NDI's.

a. The Steering Group

The DOD report stated that a steering group of high-level members of the services and DLA was established in May, 1987 to address ways to implement the recommendations of both the Packard Commission and the Defense Science Board Summer Study on commercial components.[65] Two years later, however, the GAO reported that this task force had been disbanded without taking any substantive action.[66]

As DOD explained in its April 21, 1989, letter to the Subcommittee, the steering group was disbanded because it was "deemed unnecessary." According to DOD, the "points of contact established by creation of the steering group" were used to provide high level input on various NDI issues.[67]

b. Staffing Levels

The DOD report also stated that a full-time position was established in the Office of the Secretary of Defense (OSD) in December 1986 to encourage the use of NDI's and advocate policy and procedural changes to increase NDI acquisition.[68]

However, the Subcommittee subsequently learned that there were two people on the OSD staff working full time on NDI issues prior to December 1986. In effect, DOD did not create a new staff position to address the NDI issue—it eliminated one of two existing positions. Moreover, the staff member who continued to work on the NDI issue was required to split his time between NDI and other issues, and did not have background or authority with regard to either contracting requirements or acquisition policy for major systems.[69]

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[65] DOD Report, Hearing Record, p. 244.

[66] GAO Report NSIAD 89-51, Nondevelopmental Items, p. 16. (February 1989)

[67] April 21, 1989 letter from Under Secretary of Defense Robert Costello to the Subcommittee, Hearing Record, p. 253 (hereafter, "Costello letter").

[68] DOD Report, Hearing Record, p. 244.

[69] At its June 1, 1989, hearing, the Subcommittee was informed that an additional staffer had been hired within the previous month.

Senator LEVIN. Have you asked for help?

Mr. SAUNDERS. Yes. sir.

Senator LEVIN. Have you gotten it?

Mr. SAUNDERS. Not yet, but—well, I take it back—yes, I have gotten help. We have doubled the size of the staff working on this issue.

Senator LEVIN. From 1 to 2?

Mr. SAUNDERS. Yes, sir. [Laughter.]

Continued

In addition, the three military services informed the Subcommittee that they had assigned the NDI issue to existing offices—acquisition streamlining advocates for the Army and Navy, and the departmental standardization office for the Air Force—without adding any new personnel to the issue. The Army and the Navy stated that they had no personnel solely devoted to NDI's. The Air Force stated that it could identify a total of approximately 400 staff hours that had been devoted to the issue over two and a half years—roughly ten weeks of work for one person.[70]

c. Training

DOD's record on training has been equally dismal. The 1987 report stated that the Defense Systems Management College (DSMC), the principal training center for program managers, had begun offering modules on NDI acquisition in each of their courses. The report stated that these modules covered benefits, techniques, risks, and special considerations, such as logistics support, inherent in such acquisition.[71]

In response to its 1989 inquiries, however, the Subcommittee learned that a total of approximately 40 minutes had been devoted to NDI's in the entire 20-week DSMC program managers course. Similarly, a one-week DSMC course on the fundamentals of acquisition dedicated approximately 15 minutes to NDI's.[72]

In its April 21, 1989 response to the Subcommittee's request for a status report on training, DOD states "consideration of NDI alternatives is an integral part of the case study which runs throughout the program managers course." The Subcommittee's review of this case study disclosed that, of its three and a half inches of material, a total line count of only 15 lines is dedicated to the NDI issue.[73]

Letters to the Subcommittee from the three military departments indicate an equal lack of attention to training. According to these letters, the Army's 9-week basic course on material acquisition devotes a total of 2 hours to NDI's, while the Navy's 40-hour course on the acquisition process devotes a grand total of 15 minutes to NDI's. And the Air Force was unable to identify any NDI training that it offers its employees.[74]

Finally, the Subcommittee learned that, in a memorandum dated July 28, 1987, the Undersecretary of Defense (Acquisition) requested that the DSMC conduct a series of NDI workshops at DSMC regional training centers. Like so many other NDI efforts contemplated by the Department of Defense in 1987, these workshops were never conducted.

Senator LEVIN. That is a 100 percent increase.
The Assistant Secretary of Defense (Procurement and Logistics), in a letter to the Subcommittee dated August 10, 1989, reported that the staff dedicated to the NDI issue was increased by the assignment of a three-person study team.

[70] April 20, 1989 letter from Under Secretary of the Army to the Subcommittee (hereafter, "Army letter"); April 25, 1989, letter from Acting Secretary of the Navy to the Subcommittee (hereafter, "Navy letter"); April 25, 1989, letter from Air Force Office of Legislative Liaison to the Subcommittee (hereafter, "Air Force letter"); Hearing Record, pp. 271, 277, and 281.

[71] DOD Report, Hearing Record, p. 244.

[72] Costello letter, Hearing Record, p. 253.

[73] Costello letter, Hearing Record, p. 253.

[74] Army letter, Navy letter and Air Force letter. See footnote 70 above.

d. NDI information system

In April 1988, the Director of the Office of Management and Budget requested that DOD establish a formal information system to gather and maintain data on the Department's use of commercial products.

To date, DOD has not even responded to OMB's request. As GAO reported in a February 1989 report on DOD's use of NDI's:

> In response to our request for DOD data on NDI procurement, OSD stated * * * that because of the cost and questionable usefulness associated with data gathering, little had been done to document how much NDI is being acquired.
>
> * * * * * * *
>
> OSD officials told us that no actions had been taken to develop an information system, and they had not decided what actions DOD will take in response to this matter.[75]

GAO concluded that information on NDI's would be extremely useful in several ways:

> We believe information on NDI would be useful in (1) identifying the amount and types of commercial products DOD already purchases, (2) identifying the types of products for which additional NDI opportunities may exist, and (3) assessing the effectiveness of actions taken to ensure that DOD procures NDI to the maximum practicable extent. As an illustration, DOD's collection of data on competitive contracting appears to have been useful in tracking results and encouraging increased competition.[76]

At the Subcommittee's June 1 hearing, Deputy Secretary Atwood stated that he would review the question of establishing an NDI data system and report back to the Subcommittee.[77]

Subsequent to the hearing, the Department of Defense informed the Subcommittee that it is planning to establish a data base to measure its progress in commercial acquisition.[78]

2. REGULATORY REVISIONS

In its 1987 report, DOD stated that it would revise basic acquisition regulations to incorporate the preference for and require consideration of NDI's, and that it would publish a manual and a directive specifically addressing the acquisition of NDI's.[79]

In fact, however, the regulatory changes promulgated by DOD are extremely modest and fall far short of full implementation of the statutory objectives. Neither the promised NDI manual nor the new DOD directive has ever been published. Moreover, helpful changes to DOD directives governing major and nonmajor defense systems acquisition (DoDD 5000.1 and DoDI 5000.2) are overshadowed by shortcomings in revisions to the DOD Supplement to the Federal Acquisition Regulation (FAR).

a. The NDI manual and directive

DOD's 1987 report stated that an NDI manual was being developed and would be issued by the end of 1988.[80] However, that

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[75] GAO Report NSIAD 89-51, Nondevelopmental Items, p. 17 (February 1989).
[76] GAO Report NSIAD 89-51, Nondevelopmental Items, p. 17 (February 1989).
[77] Hearing Record, p. 70.
[78] August 10, 1989 letter from Assistant Secretary of Defense for Production and Logistics to the Subcommittee.
[79] DOD Report, Hearing Record, p. 243.
[80] DOD Report, Hearing Record, p. 243.

manual, which has been in draft form for almost two years, has never been issued. As DOD's Assistant for Commercial Products, Greg Saunders, explained at the Subcommittee's June 1, 1989 hearing, the manual has never been issued because of a lack of resources devoted to the NDI effort by the Department of Defense.

Senator LEVIN. The 1987 report of the DOD stated the Department was preparing a manual on the acquisition of NDI's. Has that manual been issued?
Mr. SAUNDERS. No, it has not.
Senator LEVIN. Do you know why?
Mr. SAUNDERS. Principally because I am the person working it; and I simply have not had the time to work on that before working on some other issues.
Senator LEVIN. Is there a timetable for that manual?
Mr. SAUNDERS. No, sir. There is not at this point.[81]

Similarly, DOD stated in its 1987 report that the Department's directive on commercial acquisition (DoDD 5000.37) was being changed and expanded to promote NDI acquisition.[82] In its April 21, 1989 letter to the Subcommittee, DOD stated that "[t]he directive has been revised to include coverage of issues such as logistics support, testing and evaluation, areas needing special emphasis, and . . . expand coverage from only commercial products to include the full spectrum of nondevelopmental items." [83] DOD stated that the directive was being coordinated with the services, defense agencies, and within OSD.

Unfortunately, the revised directive, which has been in draft since March 1987, has yet to be issued. As a result, DOD still does not have a formal statement of policy and guidance implementing Section 907 at the departmental level—almost three years after the provision was enacted.

b. The DOD FAR supplement

The 1987 report also stated that the Department would revise its basic procurement regulations to incorporate the NDI preference.[84] Appropriate changes were made to DOD's primary regulations governing major and nonmajor defense systems (DoDD 5000.1 and DoDI 5000.2), but changes to the DOD FAR Supplement, which is far more widely circulated, simply do not go far enough to implement the statutory intent.

DOD's April 21, 1989 letter to the Subcommittee stated that the DOD FAR Supplement had been revised to require DOD to fulfill its needs through the acquisition of NDI's to the maximum extent practicable.[85] Attached to the letter were copies of Parts 207 and 210 of the DOD FAR Supplement, as revised. Part 207 addresses requirements for acquisition planning, while Part 210 contains the requirements for drafting specifications.

The revision to Part 207 requires that written acquisition plans, which are a prerequisite to the acquisition of complex and costly military hardware, include a discription of any market research planned or undertaken to identify NDI's that could satisfy the acquisition objectives. While this is a helpful step, Part 207 is still in-

[81] Hearing Record, pp. 77–78.
[82] DOD Report, Hearing Record, p. 243.
[83] Costello Letter, Hearing Record, p. 254.
[84] DOD Report, Hearing Record, p. 243.
[85] Costello letter, Hearing Record, p. 254.

complete in that it fails to include steps to ensure (i) the identification of NDI's that could be used as subsystems and components of military hardware, and (ii) the identification of NDI's that could be used by subcontractors on these programs.

The revision to Part 210, as reported by the Department of Defense, simply defined the term "nondevelopmental item" and provided that "it is the policy of the Department of Defense to fulfill requirements for items of supply through the acquisition of nondevelopmental items to the maximum practicable extent." In effect, this revision, which was made in April 1987, repeated the statutory requirement, without providing any procedures or guidelines for meeting the requirement.

Subsequent to the April 1987 revision to Part 210, this provision was changed again, in an effect to incorporate the statutory preference for functional and performance specifications.[86] The second change to Part 210 added the following provision:

> While there may be some mandatory design or performance requirements applied to a single phase or through the acquisition cycle, the citation of specifications, standards, and related documents shall (i) specify results desired, rather than how to design or how to manage * * *

Although this language addresses specifications and standards in a positive manner, it does not directly implement the statutory language which requires agencies to state their requirements "to the maximum extent practicable" in terms of "(A) functions to be performed; (B) performance required; or (C) essential physical characteristics." It is unclear why DoD chose not to incorporate this statutory requirement directly into the regulation.

DOD's failure to incorporate the statutory requirement in the DOD FAR Supplement is aggravated by the fact that the FAR itself contains a contrary policy. Paragraph 10.006 of the FAR mandates a preference for specifications and standards listed in the Index of Federal Specifications and Standards. The use of product descriptions to acquire commercial products is permitted as an exception to this general rule. In other words, the FAR requires that agencies should consider using purchase descriptions (which facilitate the acquisition of NDI's) in lieu of military specifications on an exception basis, rather than a preferred basis, as required by the statute. The DOD FAR Supplement does not appear to except the Department of Defense from this requirement, despite the fact that it is inconsistent with the statutory preference for functional and performance specifications.

3. EFFORTS TO ADDRESS IMPEDIMENTS

DOD's 1987 report to Congress identified five general impediments to the acquisition of NDI's, along with actions taken to address these impediments. Unfortunately, 13 additional impediments, which were identified in the draft of the report, were deleted from the final version. Even with regard to the five impediments that were identified in the final version of the report, DOD has taken minimal action to address the problems.

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[86] The copy of Part 210 that DOD provided to the Subcommittee with its April 21, 1989 letter did not include this change.

a. Contract clauses

A comparison of the draft and final versions of DOD's 1987 report reveals some obvious deletions. For example, the draft report explained in some detail the problems caused by inconsistent and inappropriate application of burdensome contract requirements. The draft stated in part:

> Government contracts for commercial products include the same clauses used in developmental contracts. While they may be appropriate for large cost reimbursable contracts, the cumulative effect of such clauses is to create a considerable impediment for commercial vendors wishing to do business with the government.
>
> * * * * * * *
>
> Inappropriate and inconsistent contract clauses used by different government agencies, different departments and agencies within the DOD, and different buying organizations within a department or agency cause confusion and uncertainty and increase a contractor's risk in doing business with the government.[87]

The report also listed six specific examples of contract clauses that were seen as impediments to the acquisition of NDI's. These included contract clauses relating to required source identification; conflicts of interest in defense contracting; validation of proprietary data restrictions; commercial pricing for spare parts, employee fraud, waste and abuse programs; allowable cost certifications; and the application of cost principles.[88]

These examples of problematic contract clauses were deleted from the final DOD report, as was the detailed explanation of the problem. Instead, the final report made the general statement that "[c]ontracts for nondevelopmental items include unnecessary clauses and there are too many and too complex regulations"—without any further explanation or examples.[89]

When asked at the Subcommittee's June 1 hearing why this material was deleted from the 1987 report, Deputy Assistant Secretary of Defense Eleanor Spector generally agreed that some of the clauses were inexplicable and the problem should be corrected, but that she did not know why the statements had been omitted or watered down. She further stated—without reference to the numerous specific examples of problematic clauses listed in the draft report—that the only clauses specifically identified by contractor representatives as significant impediments to the acquisition of NDI's related to cost or pricing data.[90]

Unfortunately, the deletion of explanatory material and specific details from the report appears to have served as an excuse for inaction on this issue. At the Subcommittee's May 16 and June 1 hearings, contractor and DOD witnesses alike were unable to identify a single example of a contract clause that had been eliminated or modified in an effort to remove impediments to the acquisition of NDI's.[91]

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[87] Draft DOD Report, Hearing Record, p. 232-33.
[88] Draft DOD Report, Hearing Record, p. 232-33.
[89] DOD Report, Hearing Record, p. 245.
[90] Hearing Record, p. 76-77.
[91] Hearing record, p. 26. DOD did report to the Subcommittee that the services and the Defense Logistics Agency (DLA) had reduced by 30 percent the line count of their respective supplements to the DFAR. DOD also stated that a study of approximately 500 regulatory requirements tied to dollar thresholds resulted in recommended eliminations of almost 20 percent and

Continued

b. Cost or pricing data

Similarly, the draft report discussed in detail the problems caused by the application of the Truth in Negotiations Act in inappropriate circumstances. The draft stated:

> There are situations where cost or pricing data are required even though prices appear to be set by market conditions or by competition, because the particular circumstances do not precisely meet the exemption criteria provided under the law.[92]

The draft went on to describe in detail four additional areas in which inappropriate requirement of cost or pricing data had discouraged commerical contractors from doing business with the government. These examples included cases in which (1) large government buys of a product skew the company's sales figures; (2) new products, clearly intended for commercial sale, do not yet have a history of "substantial sales" to the general public; (3) catalog or market price exemption not sufficiently used when purchasing services; and (4) the government continues to purchase a commercial product after the commercial world has moved on to more up-to-date products.[93]

Once again, the final DOD report deleted both the explanation of the problem and the specific examples, stating only that "The Truth-In Negotiations Act serves as an impediment, in some cases, to NDI acquisition." [94]

Moreover, as with the issue of contract clauses, the watered-down final report appears to have served as an excuse for inaction.[95] Two years after the final report was issued, Ms. Spector testified before the Subcommittee that the four problems described in the draft report still have not been acted upon, and continue to be impediments to the acquisitions of NDI's today:

> Senator LEVIN. Do you agree that the application of the exemption to these type of products has been a problem?
>
> Ms. SPECTOR. Yes, I believe it has.
>
> Senator LEVIN. And are these issues covered by the revised regulation that you are [now] working on?
>
> Ms. SPECTOR. Yes, sir; they are.
>
> Senator LEVIN. All four of those issues?
>
> Ms. SPECTOR. Yes, sir; they are.
>
> Senator LEVIN. Each of those four problems that I just listed was specifically identified as [an] impediment to the procurement of NDI's [in] the draft of the DOD 1987 report [and] the final version of the report deleted that information.
>
> Do you know why the reference to those specific problems was deleted from that 1987 report?
>
> Ms. SPECTOR. No.
>
> * * * * * * *
>
> Senator LEVIN. Let me read you the draft report provisions here.

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modification of another 12 percent. Costello Letter, Hearing Record, p. 256. While the reduction of unnecessary regulatory provisions is a worthwhile project, DOD did not establish any link between the regulations that were eliminated or recommended for elimination and the acquisition of NDI's.

[92] Draft DOD Report, Hearing Record, p. 230.

[93] Draft DOD Report, Hearing Record, p. 230-31.

[94] DOD Report, Hearing Record, p. 249.

[95] DOD did issue a policy memorandum to the services and defense agencies on May 1, 1987, in which it provided guidance on when cost or pricing data should be obtained. However, this memorandum addressed only the competition exemption to cost or pricing data requirements, and not the commercial pricing exemption. Moreover, the DOD guidance would have had greater impact and broader circulation if it had been issued as a regulatory change, rather than a policy memorandum.

Item 1: Sales of product to the private sector originally met percentage requirements to be exempt from submission. Large Government buys skew the percentage to the extent that subsequent buys no longer qualify for the exemption, even though the product is still being sold in the same substantial quantities to the general public.

I mean, that sounds just like what I was saying today, and what you agreed to. And yet, that was deleted.

Ms. SPECTOR. Yes. I do not know why.

Senator LEVIN. Another one: A newly-developed product, clearly intended for sale to the general public, but without a history of substantial sales to the general public. That is the language from this draft report; and that is what I read to you. And that is what you said is a problem.

Ms. SPECTOR. Yes it is. I do not know why those were deleted.[96]

Ms. Spector testified that DOD now believes that these are significant problems and intends to propose revised regulations on the application of the commercial exemption to cost or pricing data requirements in the near future.

c. Other deletions from the draft report

The explanation and examples of problems with contract clauses and cost or pricing data requirements were not the only materials deleted from DOD's draft NDI report. The draft of the report to Congress identified 13 other specific impediments to the acquisition of NDI's which were omitted from the final version in their entirety.[97] These were:

(1) Inefficient and segmented agency record-keeping systems;

(2) Excessive warranty demands;

(3) Costly and time-consuming testing prior to award;

(4) Minor modifications of commerical products, which result in small, ineffective production runs;

(5) Unique government requirements for marking products;

(6) Inappropriate use of government specifications and standards;

(7) The requirement that commercial manufacturers bear development, testing, tooling and facilitization costs for modifications requested by the government;

(8) The requirement that contractor offers remain open for as much as 90 to 120 days;

(9) The requirement of a contract modification for every insignificant change that is made to the product;

(10) Excessive record keeping and government oversight requirements;

(11) Excessively detailed product descriptions and excessive numbers of offers requiring review;

(12) Delays and other costs resulting from the liberal bid protest system; and

(13) DOD's inability to use commercial market acceptability as a precondition to bidding.

Without even addressing the validity of these impediments identified in the draft report, their deletion is clearly significant. By omitting all reference to these issues from its final report, the Department chose to duck the problem of reducing impediments to NDI acquisition, rather than facing up to the issue.

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[96] Hearing Record, p. 92-93.

[97] Draft DOD Report, Hearing Record, p. 228-34.

d. Other impediments in the final report

Virtually no action has been taken by DOD to address the three other impediments that were discussed in the final version of the DOD's 1987 report.

First, the 1987 report states that the Cost Accounting Standards (CAS) are an impediment to the acquisition of commercial products.[98] The only action taken in this area—raising the threshold for the application of CAS standards form $100,000 to $500,000, was taken by Congress in the OFPP Reauthorization Act, not by DOD.[99]

Second, the report states that government requirements for technical data rights are an impediment to the acquisition of commercial products.[100] Since the enactment of the NDI provision, DOD has issued new technical data regulations, which better address the needs of commercial producers and other manufacturers of NDI's. However, these new regulatons were issued in response to a direct requirement by the Congress, in the Defense Authorization Act for Fiscal Years 1988 and 1989.[101]

Finally, the report states that there are some rules for participation in the GSA multiple award schedule program which discourage qualified offerors from participating. According to the report, these include the following:

A requirement for most favored customer pricing when the government is not necessarily a favored customer.
A price reduction clause which requires extensive record keeping.
Maximum order limitations that do not reflect quantity price break-points.
Government access to records and data.[102]

In its April 21, 1989 response to the Subcommittee's request for a status report on this item, DOD did not address these issues at all. Instead, DOD reported it was considering regulations that would (i) eliminate the requirement to recompete items on the GSA schedules; and (ii) convert GSA schedules from mandatory to optional use.[103]

Moreover, the DOD report did not even discuss the single most significant impediment involving the GSA schedules: the fact that DOD contracting officers often require contractors to provide to them the exact same information that is required by GSA in order to place an item on the multiple award schedules. The result of this requirement is that contractors have to prove commerciality twice: first to get the product on the GSA schedule and then to sell it to DOD.[104]

As a result of the Subcommittee's hearings, the Department of Defense issued a memorandum requiring contracting officers to accept GSA's determinations of commerciality and thereby eliminating the duplicative requirement.[105]

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[98] DOD Report, Hearing Record, p. 246.
[99] 41 U.S.C. 422, as amended by Section 5(f)(2) Office of Federal Procurement Policy Act of 1988, Public Law 100-679.
[100] DOD Report, Hearing Record, p. 247.
[101] Section 808 of the National Defense Authorization Act for Fiscal Years 1988 and 1989.
[102] Draft DOD Report, Hearing Record, p. 229.
[103] Costello Letter, Hearing Record, p. 258.
[104] Hearing Record, p. 32, 45.
[105] June 20, 1989 memornadum from Eleanor R. Spector to the Assistant Secretaries of the Army, Navy, and Air Force and the Directors of Defense Agencies.

e. Other actions since 1987

In a March 23, 1989, letter to the Department of Defense, the Subcommittee asked DOD to list (i) additional impediments to the acquisition of NDI's that had been identified; and (ii) additional actions that had been taken to implement the NDI provision since 1987.

In response to this request, DOD stated that no additional impediments to the acquisition of NDI's had been identified since its 1987 report.[106] However, DOD did identify the following additional actions that had been taken to implement the NDI provision:

(1) The Pilot Contracting Activities Program;

(2) The Bank Card Program;

(3) The DOD Contract Simplification Workshop;

(4) Clarification of when to obtain cost on pricing data.

(5) The review of specifications and standards;

(6) Suspension of issuance of revision of military specifications; and

(7) Increased reliance on non-governmental standards.[107]

The efforts that DOD has made in the area of simplification of government specifications (items (5), (6), and (7)) are clearly worthwhile. Unfortunately, as explained in the previous section, the Department still has a very long way to go before any real progress can be reported in this area. Similarly, as discussed above, DOD still has a long way to go in clarifying the application of cost or pricing data requirements to the acquisition of commercial products (item (4)).

The other actions listed in the DOD report are either of extremely limited scope or have had minimal impact on the acquisition of NDI's.

For example, the Pilot Contracting Activities Program (item 1) is an attempt to increase the authority of DOD contracting personnel by encouraging them to identify regulations, clauses and procedures that may be inappropriate and providing them a means to obtain approval not to use them. While such waivers could be helpful, they have not been widely utilized to date. According to GAO, the 45 contracting activities included in the program made a total of only 459 requests for deviations or waivers over a period of a year and a half—barely 10 requests per command. Moreover, GAO reports that those requests that have been made were "relatively minor in scope."[108]

Similarly, the contract simplification workshop (item 3) has so far focused on the format of contracts, rather than on the unnecessary and burdensome requirements imposed on some contractors. The workshop has produced a proposal for a new solicitation cover sheet, a simplified contract format, and the use of annual (instead of contract-by-contract) certifications and representations. However, none of these proposals has yet been implemented.

Finally, a review of the Bank Card Program (item 2) fails to establish any significant connection with the NDI issue, and DOD

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[106] Costello Letter, Hearing Record, p. 258.
[107] Costello Letter, Hearing Record, p. 256.
[108] GAO Report NSIAD 89-51, Nondevelopmental Items, p. 38 (February 1989).

has failed, as discussed above, to make any significant progress on the cost or pricing data issue (item 4).

f. Proposed legislation

Finally, DOD's 1987 report to Congress indicates the Department has provided input to and supports proposed legislation on Commercial Products Acquisition developed by the Office of Federal Procurement Policy (OFPP).[109]

DOD stated that this Act would (i) authorize the use of short form contracts, (ii) allow for market acceptability to be a condition for contract award, (iii) require evaluation of offers to be based on best value rather than solely on price, and (iv) reduce the number of statutes and regulations that apply to commercial acquisition.

Two years later, the draft legislation still has not been submitted to Congress. Moreover, the Subcommittee has learned that the OFPP bill would authorize DOD to waive any and all statutory and regulatory requirements with regard to commercial purchases, without identifying which statutory and regulatory requirements are impediments and when it would be necessary to waive them.[110]

In short, DOD and OFPP have attempted to take a short-cut approach of simply sweeping away all of the procurement rules, without doing the hard work of identifying specific impediments and addressing them. As a result, the hard work remains to be done.

4. FINDINGS AND RECOMMENDATIONS

a. Staffing, training and tracking

Finding No. 10

The resources dedicated to the NDI initiative within the Office of the Secretary of Defense (OSD) and contracting activities have been inadequate to implement the NDI legislation fully throughout the Department.

Recommendation

The Department of Defense should establish adequate staffing at the OSD level to formulate the Department's policy on the acquisition of NDI's and to monitor its implementation. In addition, the Department should establish a responsible individual in each contracting activity to ensure that the policy on NDI's is implemented by local commands. These individuals should play an active role in encouraging the use of NDI's, ensuring that command personnel are properly trained in the use of functional and performance specifications, and challenging barriers to the use of NDI's.

Finding No. 11

The Department of Defense has failed to establish a training program adequately to train the acquisition community—including both requirements and contracting personnel—in the policies and procedures for acquisition of NDI's.

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[109] DOD Report, Hearing Record, p. 251.
[110] Hearing Record, p. 80–81.

Recommendation

The Department of Defense should establish a formal training program to provide for the initial training and periodic refresher training of the acquisition community in the identification, procurement, and logistical support of NDI's. This training program should cover the purchase of NDI's both as end items and as components of military-unique systems.

Finding No. 12

The Department of Defense has failed to establish an information system to gather and maintain data on the use of commercial products, as directed by the Office of Management and Budget in April 1988.

Recommendation

The Department of Defense should establish a system to gather and maintain data on the use of commercial products and other NDI's.

b. Regulatory revisions

Finding No. 13

The Department of Defense does not have a formal, published set of policies and procedures at the departmental level for the acquisition of NDI's. Despite commitments made by the Department, DOD Directive 5000.37 (Acquisition and Distribution of Nondevelopmental Items) and the DOD manual on acquisition of NDI's have not been published.

Recommendation

The Department of Defense should ensure that DOD Directive 5000.37 and the manual on acquisition of NDI's are completed and published on an expedited basis.

Finding No. 14

The requirement in Part 10 of the Federal Acquisition Regulations that creates a preference for Federal specifications over functional product descriptions is inconsistent with Section 907's preference for functional and performance specifications. The Department's supplement to the Federal Acquisition Regulations does not correct this problem.

Recommendation

The Department of Defense should initiate a change to either Part 10 of the Federal Acquisition Regulations or the Department's supplemental instructions requiring that the Department state its needs in a manner consistent with the Section 907. The regulation should require that the Department's needs be stated, to the maximum extent practical, in terms of (i) functions to be performed, (ii) performance required, or (iii) essential physical characteristics.

c. Efforts to address impediments

Finding No. 15

The Department of Defense's Report to Congress on its implementation of Section 907 failed to address 13 impediments to the acquisition of NDI's that were identified in a draft of the same report.

Recommendation

DOD should review and determine the validity of the impediments identified in its draft report to Congress and, where appropriate, initiate action to remove such impediments.

Finding No. 16

The Department of Defense has failed adequately to comply with Section 907's requirement to identify all statutes and regulations that impede the acquisition of nondevelopmental items.

Recommendation

The Department of Defense should undertake a systematic review of statutes and regulations that may impede the acquisition of nondevelopmental items and take necessary actions to remove such impediments.

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